

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2008

FRIDAY, MARCH 9, 2007

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 8:50 a.m., in room SD-138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Bond, and Allard.

COMMODITY FUTURES TRADING COMMISSION

STATEMENT OF HON. REUBEN JEFFERY III, CHAIRMAN

ACCOMPANIED BY:

MIKE DUNN, COMMISSIONER
WALT LUKKEN, COMMISSIONER

STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good morning and welcome. I'm going to start a few minutes early, which is totally atypical of Capitol Hill but it's an indication of the fact that we are going to have a rollcall vote at about 9:30 and I have a dual responsibility of chairing this important subcommittee and serving as majority whip on the floor. So I'll have to be there right as the rollcall begins and we'll have to interrupt this hearing for a brief time, as two votes are taken. So I apologize to those who may be a little bit surprised by a 10-minute earlier start but I hope that we can get this underway, make some progress, break for the votes and return and conclude.

I'm pleased to welcome those who are in attendance to the first in a series of public hearings we're going to conduct to consider the funding requests of several of the dozens of Federal agencies within the jurisdiction of this new Appropriations Subcommittee on Financial Services and General Government.

I appreciate the willingness of those who are in attendance to accommodate their scheduling to the date, time, and location. I'm glad you're all here. I welcome my colleagues who will join me, I'm sure, as the subcommittee hearing is underway. This morning, we will be hearing from two distinguished panels of witnesses.

First, I'm pleased to welcome Chairman Reuben Jeffery of the Commodity Futures Trading Commission (CFTC). I believe Commissioner Mike Dunn is here. I don't know if Mr. Lukken is in attendance at this point but he may join us a little later.

Our second panel will feature testimony from Steven Preston, Administrator of the Small Business Administration (SBA). To a casual administrator, these two agencies may seem quite dissimilar and oddly matched. Certainly their assigned missions and obligations are distinctive yet both of these agencies occupy pivotal positions at the forefront of stimulating economic growth in our country.

The Commodity Futures Trading Commission, created in 1974, is responsible for fostering the economic utility of futures markets by encouraging their competitiveness and efficiency, their integrity and protecting market participants against manipulation, abusive trade practices and fraud. That oversight and enforcement mission becomes tangible when you consider that the prices established by the futures market directly or indirectly affect the lives of all of us. Futures prices impact the prices we pay for necessities of life—our food, clothing, shelter, fuel for vehicles, and heat in our homes. Moreover, since the agency's inception, there has been a remarkable transformation in this futures industry. Thirty years ago, the vast majority of trading occurred in the agricultural sector. Today, novel, highly complex financial contracts based on such things as foreign currency, interest rates, Treasury bonds, weather, real estate, economic derivatives, stock market indices—the list goes on. But that list has gone far beyond the original mission of agricultural contracts.

Financial derivatives now comprise approximately 82 percent of all exchanged derivative activity, 8 percent for agriculture. Ever expanding complexities pose ever demanding challenges. I'm proud to have the two largest futures exchanges in the United States, the Chicago Mercantile Exchange (CME) and the Chicago Board of Trade (CMBOT) headquartered in Illinois and one of CFTC's three regional offices located there as well. These exchanges recently set an all-time total daily trading volume record of 24,915,515 contracts cleared through CME, CMBOT Clearing Agreement.

The President's budget proposes \$116 million in funding for the CFTC for the next fiscal year. This sum represents a hike of 18 percent over the \$98 million provided for fiscal year 2007 under our continuing resolution. It is 9 percent below the \$127 million level the President sought in fiscal year 2007.

Now the Small Business Administration will follow after the CFTC. It was established in 1953. We know its general mission to promote and protect the viability of America's entrepreneurs, innovators, and small business owners. In my home State of Illinois, the contributions of the estimated 1,087,700 small businesses are critical to our economy, creating over 2.6 million jobs in my State. Our Nation depends on the SBA to ensure that capital assistance is available for those who need it the most.

Like the CFTC, the SBA has experienced dramatic growth in the programs it offers. SBA's programs now include financial and Federal procurement, management assistance, specialized outreach to women, minorities, and Armed Forces veterans.

For the Small Business Administration, the President seeks \$464 million in new budget authority for the next fiscal year. No new budget authority is requested for disaster loan programs, since there are sufficient carryover balances to operate them. The

amount requested is a reduction from the last fiscal year's continuing resolution of \$108 million. This can be attributed to the fact that funding was provided in that continuing resolution for disaster loan administrative expenses and no new funds are requested for that purpose.

There are many questions that I will raise about the SBA as we get into it, particularly about the microloan program but in the interest of moving this forward, I would like at this point to introduce Chairman Jeffery and welcome him to this new subcommittee of Appropriations, the first inaugural hearing and say that the floor is yours and I'd invite you to proceed with your testimony.

STATEMENT OF CHAIRMAN JEFFERY

Mr. JEFFERY. Thank you very much, Mr. Chairman. It's an honor to be here today to testify on behalf of the Commodity Futures Trading Commission. Today, I'd like to discuss the impact of the commodity futures and options industry on the everyday lives of Americans, the mission and program responsibilities of the agency and finally, our fiscal year 2008 justification for the \$116 million funding level requested by the administration.

This proposed funding level will enable the Commission to address two major needs: staff increases and technology investment.

During the past 10 years, as can be seen in figure 1 on the screen to my left, trading volume on U.S. futures exchanges has quintupled. Today, in a single day of trading, markets will move more than \$5 trillion of notional value. The industry, as you, Mr. Chairman, correctly and very eloquently pointed out, has grown from largely agricultural product hedging risks to a broad array of complex products related to both physical commodities and financial instruments.

At the same time, however, Commission staffing levels have fallen to 458 full-time employees. This compares with 497 employees in 1976, the Commission's first full year of operation. Commission employees work hard. They work smart and they use technology effectively. But they are severely stretched.

While the daily business of CFTC can appear from the outside looking in to be somewhat obscure and highly technical in nature, the mission of the agency is quite clear and two-fold: First, to protect the public and market users from manipulation, fraud and abusive practices and second, to promote open, competitive and financially sound markets for commodity futures.

This is important because the futures markets are used in the price discovery process, affecting the price of a bushel of wheat, the cost of a gallon of gas, the interest rate on a student loan. If the futures markets fail to function properly, all consumers are affected.

The CFTC is the sole Federal regulator responsible for overseeing these futures markets. Through effective oversight, the CFTC enables the futures markets to better serve their vital function in the Nation's economy, providing an effective marketplace for price discovery and risk management.

RECORD GROWTH IN FUTURES INDUSTRY

To achieve these goals, the Commission employs a well-trained and dedicated staff who work within three major programmatic areas: market oversight, clearing and intermediary oversight, and enforcement. Market oversight ensures that the markets are operating efficiently and without manipulation and fraud. One workload indicator is the number of actively traded contract types on U.S. exchanges. As can be seen in figure 2, the number has more than quintupled in the past decade, with particularly significant growth seen in the last 5 years. In fact, by next year, the number of actively traded contracts is anticipated to climb to nearly 1,600, a record high. There is every indication that this significant growth in new and novel products will continue.

The CFTC must maintain a sufficient level of specialized expertise to review and analyze a very diverse group of instruments and products to ensure that they are economically viable and not susceptible to manipulation.

Clearing and intermediary oversight ensures the financial integrity of transactions on the futures markets. The CFTC oversees the principle clearing operations associated with the major commodity exchanges in Chicago, in Kansas City, and in New York. And the agency oversees market intermediaries, including some 200 futures commissions merchants, the ranks of which include banks and broker dealers with specialized futures and commodities operations as well as stand-alone futures trading houses.

Figure 3 shows that the amount of customer funds held by futures commissions merchants in segregated accounts has quadrupled over the past decade, meaning that more and more Americans are investing in the futures markets, either directly or indirectly through their participation in pension funds, mutual funds, or other institutions.

ENFORCEMENT

Turning to enforcement, this is an area in which the CFTC takes great pride. The CFTC polices the markets through strong enforcement, going after unscrupulous firms and individuals, both on and off exchange. Manipulation, fraud, and other violations undermine the integrity of the market and confidence of market participants.

Figure 4 has some statistics related to the Commission's recent enforcement activity in the areas of foreign currency and energy over the past 5 years. In the FX markets, 93 cases have been filed resulting in judgments approximating \$500 million. In the energy area, the CFTC has brought 35 cases resulting in over \$300 million of civil sanctions.

With the demand for enforcement resources, however, exceeding capacity, the CFTC must make hard choices every day on how to prioritize scarce investigative and litigation efforts.

INCREASED FUNDING FOR AGENCY

We are grateful for the administration's recognition of the need for increased funding for the agency. The 2008 President's budget request as depicted in figure 5, is for an appropriation of \$116 mil-

lion and 475 employees—an increase of approximately \$18 million and 17 people over the fiscal year 2007 continuing resolution level.

Specifically, compared to 2007, the key changes in the 2008 budget are roughly \$3 million to provide increased compensation and benefit costs for the existing staff of 458, another \$3 million to cover the salary and benefits related to the 17 additional full-time employees and \$12 million for increased operating costs associated with information technology modernization, lease-hold expenses and other services.

This funding increase provides the Commission with the financial wherewithal to hire additional staff and to invest in technology. In staffing, the CFTC must compete for talent not only with the private sector but also with other financial regulators. Four years ago, the Congress improved the CFTC's ability to compete, granting the agency comparable pay authority with other financial agencies, so-called pay parity through Federal Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). For this authorization, which leveled the compensation playing field, all of us at the CFTC are deeply grateful. It's been a huge help. However, the agency has not yet been fully funded to the level of comparable FIRREA agencies.

Second to human capital, technology is the single most effective tool in assisting those professionals who oversee the markets. Budgetary constraints have required the Commission over several years to put new systems development initiatives and hardware and software investment on hold, as indicated in figure 6. That's not a trend of which we are particularly proud.

CFTC analysts rely primarily on two proprietary computer systems for visibility into the markets. One gives us the ability to see who is trading in the markets and who is building leverage in the market or becoming a large trader, thus developing a position that may influence market conditions. The second allows us to pull in all transactional data from traditional exchanges to identify trading patterns that might be indicative of inappropriate or manipulative trading activity.

These two systems are unique in their ability to provide transparency into cross-market trading activity across all futures markets under the Commission's jurisdiction. Their importance to ensuring market integrity cannot be overstated.

PREPARED STATEMENT

In conclusion, all of us at the CFTC take great pride in our work. I can assure you that we are working diligently and efficiently to fulfill the important responsibilities with which the Congress and the American people have entrusted us. Thank you again for the opportunity to appear before you today on behalf of the agency and I'd be happy to attempt to answer any questions that you might have.

[The statement follows:]

PREPARED STATEMENT OF REUBEN JEFFERY III

Thank you, Mr. Chairman and members of the subcommittee. I am pleased to be here to testify before you on behalf of the Commodity Futures Trading Commission, and I appreciate the opportunity to discuss issues related to the Commission's 2008 budget request.

Today I would like to discuss the impact of the commodity futures and options industry on the everyday lives of Americans, the mission and program responsibilities of the agency and, finally, our fiscal year 2008 congressional justification for the \$116 million funding level requested by the administration. This proposed funding level will enable the Commission to address its two major needs—staff increases and technology investment.

During the past 10 years, as can be seen in figure 1, trading volume on U.S. futures exchanges has quintupled. Today, in a single day of trading, our markets will move more than \$5 trillion. The industry has grown from largely agricultural product hedging to a broad array of complex instruments related to both physical commodities and financial instruments. Trading volume, measured by numbers of contracts traded, has more than tripled in just the past 6 years. At the same time, Commission staffing levels have fallen to 458 full-time employees. This compares with the 497 FTEs 30 years ago in 1976—the Commission’s first year of operation. Commission employees work hard, work smart, and use technology effectively, but given the complexity of the markets we oversee, they are stretched.

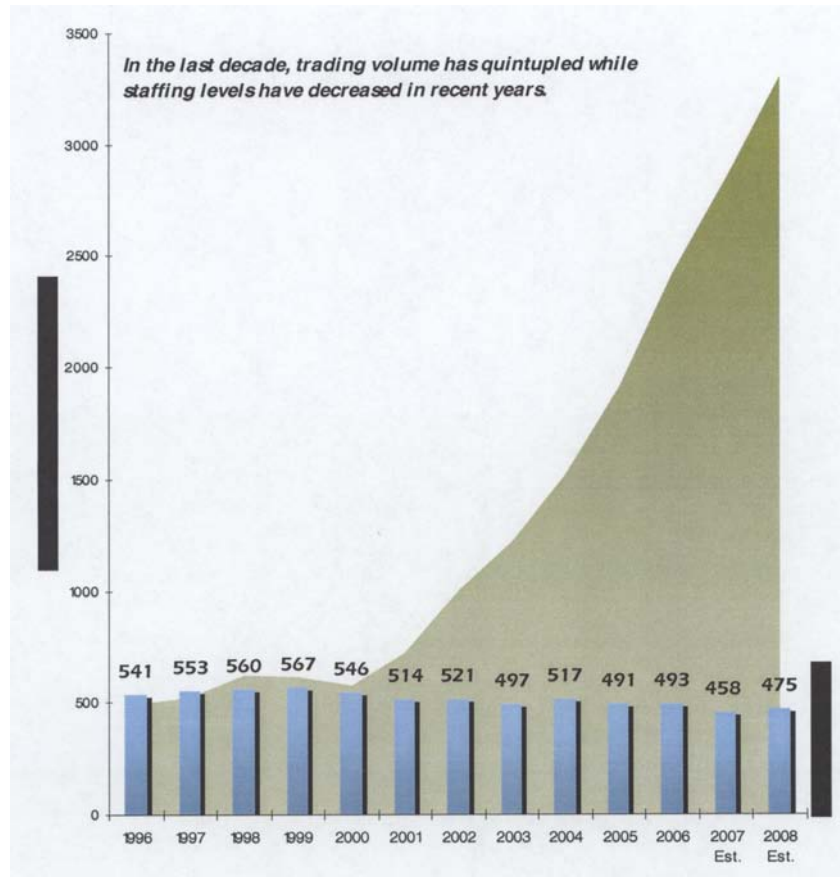


FIGURE 1.—Growth of Volume of Contracts Traded and FTEs

MISSION OF THE AGENCY

While the daily business of the CFTC can appear from the outside looking in to be somewhat obscure and highly technical in nature, the mission of the agency is very clear: (1) to protect the public and market users from manipulation, fraud, and abusive practices and (2) to promote open, competitive and financially sound markets for commodity futures. This is important because the futures markets are used

in the price discovery process affecting the price of a bushel of wheat, the cost of a gallon of gas, and the interest rate on a student loan. If the futures markets fail to work properly all consumers are impacted.

Congress created the CFTC in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States. The Commission's mandate has been periodically renewed since then. In December 2000, Congress reauthorized the Commission through fiscal year 2005 with passage of the Commodity Futures Modernization Act of 2000 (CFMA).

COMMISSION STRUCTURE

The CFTC is the sole Federal regulator responsible for overseeing the futures markets by encouraging competitiveness and efficiency, ensuring market integrity, and protecting market participants against manipulation, abusive trading practices and fraud. Through effective oversight, the CFTC enables the commodity futures markets better to serve their vital function in the Nation's economy—providing an effective marketplace for price discovery and risk management.

To achieve these goals, the Commission employs a well-trained and dedicated staff who work within three major programs—market oversight, clearing and intermediary oversight, and enforcement.

Market Oversight

Market oversight ensures that the markets are operating efficiently and without manipulation and fraud. One workload indicator is the number of actively traded contracts trading on U.S. exchanges. As can be seen in figure 2, the number has more than quintupled in the last decade, with particularly significant growth seen in the last 5 years, or since the passage of the CFMA. Prior to 2000, the number of contract types traded was relatively stable at a level of around 250. By next year in fiscal year 2008, the number of actively traded contracts is anticipated to climb to nearly 1,600, a record high. There is every indication that this significant growth in new and novel products will continue.

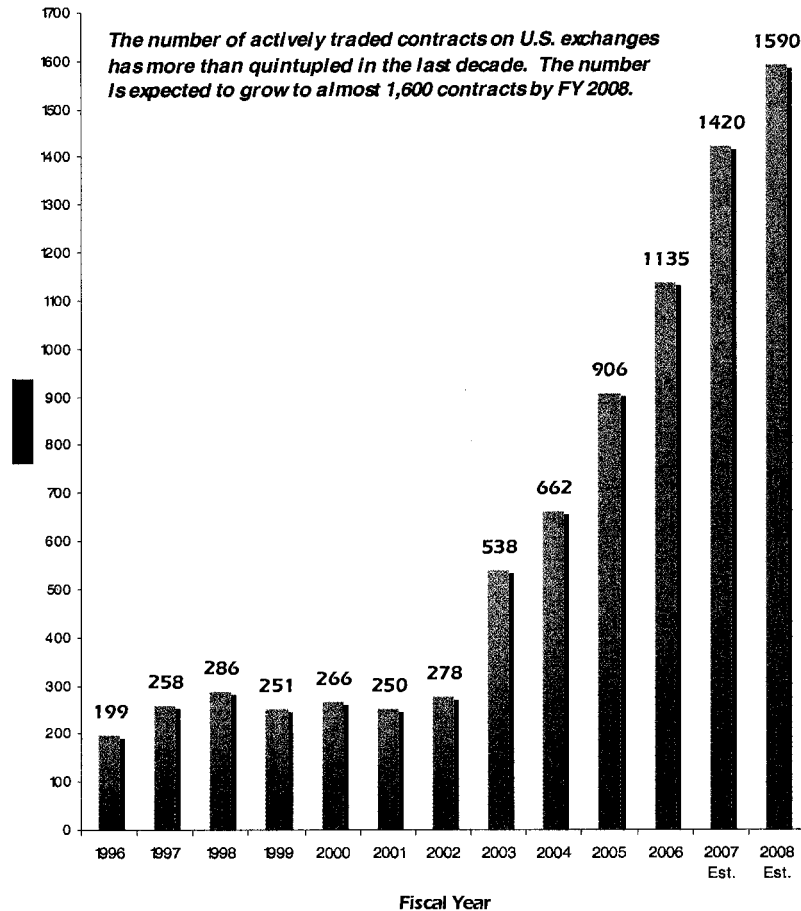


FIGURE 2.—CFTC Actively Traded Contracts

The CFTC must maintain a sufficient level of specialized expertise to review and analyze a very diverse group of instruments and products to ensure that they are economically viable and not susceptible to manipulation. The types of new products run the gamut from traditional commodity areas, such as new agricultural and energy futures, to novel financial derivatives based on credit risk, weather-related occurrences and effects, pollution allowances, real estate, and instruments having characteristics of both securities and commodities. Our analysts employ various methods to ensure an understanding of how the markets are functioning to develop a flexible, effective regulatory response to market conditions.

Clearing and Intermediary Oversight

Clearing and intermediary oversight ensures the financial integrity of all transactions on the markets that we regulate. The work of the staff is to ensure that the intermediaries managing these funds are properly registered, perform appropriate recordkeeping, have adequate capital, employ fair sales practices, and fully protect the funds their customers invest. The principal clearing operations are associated with the major commodity exchanges in New York, Chicago and Kansas City. Intermediaries overseen by the CFTC include some 200 futures commission merchants, the ranks of which include banks and broker-dealers with specialized futures operations, as well as stand alone futures trading houses.

In figure 3, one can observe that the amount of customer funds held by futures commission merchants has quadrupled over the past decade—meaning more and more Americans are investing in futures markets directly or indirectly through their participation in pension funds, mutual funds, and other institutions.

The amount of customer funds held at futures commission merchants has more than quadrupled in the last decade.

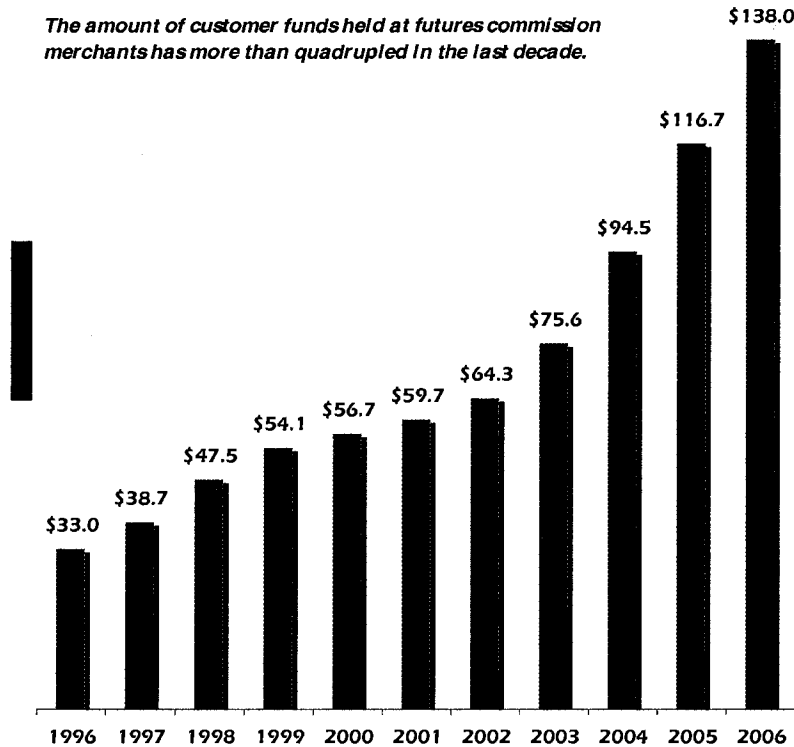


FIGURE 3.—Customer Funds in FCM Accounts

Enforcement

The CFTC prides itself on its vigorous enforcement operation. Through strong enforcement, CFTC polices the markets—going after unscrupulous firms and individuals both on and off-exchange. Manipulation, fraud and other violations undermine the integrity of the market and the confidence of market participants.

Figure 4 presents the results of the Commission's recent enforcement activity in the foreign currency and energy areas respectively. In the foreign currency or FOREX markets, 93 cases involving 354 entities or persons were filed with over \$292 million in sanctions levied and \$182 million in restitution. Since the collapse of Enron, CFTC brought 35 cases involving energy markets and charged 55 entities or persons with manipulation, attempted manipulation, and/or false price reporting. The collective civil monetary sanctions levied exceed \$302 million in these matters.

| Actions Taken Since Passage of the CEMA in December 2000 | | Foreign Currency Markets |
|--|--|--------------------------|
| Number of Cases Filed or Enforcement Actions | | 93 |
| Number of Entities/Persons Charged | | 354 |
| Number of Dollars in Penalties Assessed: | | |
| Civil Monetary Penalties | | \$292,042,098 |
| Restitution | | \$182,471,571 |
| Actions Taken Since Enron Bankruptcy in December 2001 | | Energy Markets |
| Number of Cases Filed or Enforcement Actions | | 35 |

| Actions Taken Since Enron Bankruptcy in December 2001 | Energy Markets |
|---|----------------|
| Number of Entities/Persons Charged | 55 |
| Number of Dollars in Penalties Assessed: Civil Monetary Penalties | \$302,863,500 |

FIGURE 4.—*Spotlight on Foreign Currency and Energy Markets*

With the demand for enforcement resources exceeding capacity, CFTC must make hard choices every day on how to prioritize our investigative and litigation efforts.

Mission Support

The three major Commission programs are complemented by other offices, including our Office of the Chief Economist, Office of the General Counsel, Office of International Affairs and Office of Proceedings. The Commission's Executive Direction is comprised of the chairman's and Commissioners' offices providing agency direction, and stewardship over CFTC's human capital, financial management, and information technology resources.

The Commission is headquartered in Washington, DC, and maintains regional offices in Chicago, New York, and Kansas City. In recent years, budgetary considerations led to the decision to close the Los Angeles and Minneapolis offices.

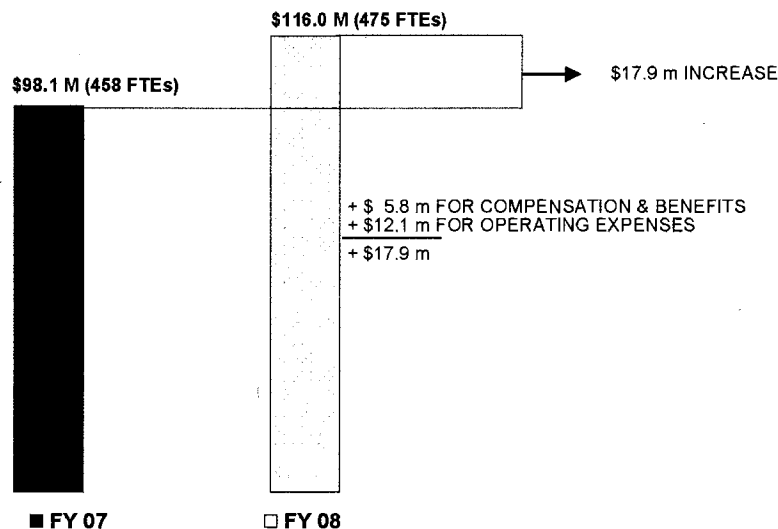
When looking at the increased volume of activity across all areas of the CFTC mission, and the scope of the industry change since 2000, the resulting increase in specialized workload is demonstrable. Accordingly, it is critical that the CFTC have sufficient resources to hire and maintain requisite skilled talent, as well as provide a steady stream of technology investment commensurate with the agency's expanding and evolving mission.

FISCAL YEAR 2008 PRESIDENT'S BUDGET REQUEST

We are grateful for the administration's recognition of the need for increased funding for our agency.

The fiscal year 2008 President's budget request, as seen in figure 5, is for an appropriation of \$116 million and 475 staff-years, an increase of approximately \$18 million and 17 staff-years over the fiscal year 2007 continuing resolution appropriation of \$98 million which supports a level of 458 staff-years.

FY 2008 President's Budget & Performance Plan

FIGURE 5.—*Fiscal Year 2008 Budget Request Provides for Current Services and 17 Additional FTEs*

Compared to the fiscal year 2007 continuing resolution appropriation, key changes in the fiscal year 2008 budget are:

- \$2.8 million to provide for increased compensation and benefit costs for a staff of 458 FTEs;
- \$3.0 million to provide for salary and expenses of 17 additional full-time equivalent staff-years;
- \$12.1 million to provide for increased operating costs for information technology modernization, lease of office space, and all other services.

This funding increase provides the Commission with the financial wherewithal to hire additional staff and to invest in technology. In staffing, the CFTC must compete for talent not only with the private sector, but also with the SEC and other Federal financial regulators. Four years ago, the Congress improved our ability to compete, granting the CFTC comparable pay authority with other financial agencies (so called “pay parity” through FIRREA). For this authorization to level the compensation “playing field” all of us are deeply grateful. However, the agency has not yet been fully appropriated to the level of comparable FIRREA agencies.

Second only to our human capital, technology is the single most effective tool in assisting those professionals who oversee the markets. Budgetary constraints have required the Commission over several years to put new systems development initiatives and hardware and software purchases on hold, as indicated in figure 6.

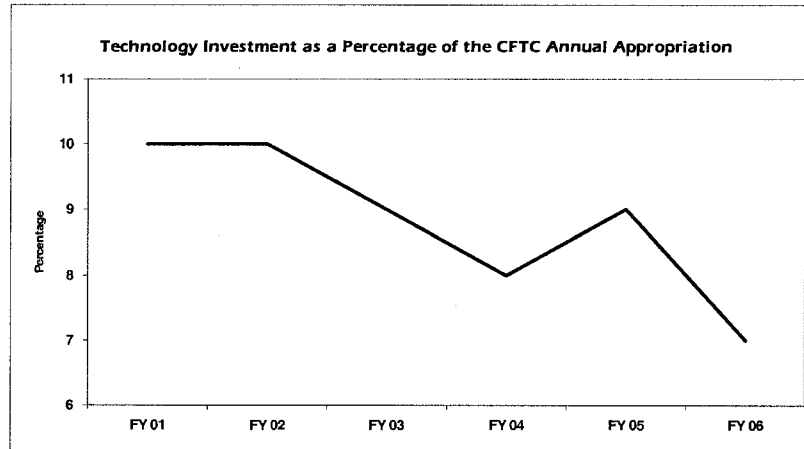


FIGURE 6.—*Technology Investment*

CFTC analysts rely primarily on two proprietary computer systems for visibility into the markets. One gives us the ability to see who is trading in the markets and who is building leverage in the market or becoming a large trader—thus developing a position that may influence market conditions. The second allows us to pull in all transactional data from traditional exchanges to identify trading patterns that might be indicative of inappropriate or manipulative trading practices. These two major systems are unique in their ability to provide transparency into cross-market trading activity across all futures markets under the Commission’s jurisdiction. Their importance to ensuring market integrity cannot be understated.

The Commission respectfully requests the proposed funding increase for mission-critical investments in people and technology in order to keep up with the dynamic commodity futures and options industry. While relatively small in dollar terms this funding increment is necessary to ensure that CFTC continues to be able to fulfill its statutory mandate.

All of us at the CFTC take great pride in our work. I can assure you that we are working diligently and efficiently to fulfill the important responsibilities with which the Congress and the American public have entrusted to us.

This concludes my formal testimony. Thank you for the opportunity to appear before you today on behalf of the CFTC. I would be happy to answer any questions you may have.

An electronic version of the Commodity Futures Trading Commission “FY 2006 Performance and Accountability Report” is available on the Internet at www.cftc.gov/cftcreports.htm.

Senator DURBIN. Thank you very much. I note the presence of Commissioner Walt Lukken. Thank you for joining us and I'd say to Senator Bond, I started a few minutes earlier with my opening statement because of the vote we face at 9:30 but I'll give you a copy to read on the plane back to St. Louis.

Senator BOND. I can't wait.

Senator DURBIN. I know you can't. Thank you for joining us this morning. Let me ask you a few questions, Chairman Jeffery and then turn to my colleague.

Your current staff level is 450. It's the lowest in the history of the CFTC Commission as I understand it. The graph you presented at the outset depicted the surge in industry volume growth and it's a sharp contrast with stagnated staffing levels. It makes a compelling case as to whether or not you are prepared to really meet this vast increase in the volume of activity and the increased sophistication of the trading mechanisms that are at hand.

I'm informed the CFTC lost 58 experienced employees in fiscal year 2006, 23 more to date in fiscal year 2007. The 81 staff that have departed include 26 attorneys, 7 economists, 8 futures trading specialists, 9 division office directors, 2 commissioners, 15 executive and management support and 14 staff in other job categories. Moreover, since October 2005, you've been operating under a hiring freeze.

I also have jurisdiction in the subcommittee over the Securities and Exchange Commission. It is interesting to note what is going on there. In 1976, there were 2,054 employees at the Securities and Exchange Commission. By 2006, the number was up to 3,549, a 73-percent increase in staffing at the Securities and Exchange Commission, which has a similar responsibility as the CFTC. While their staffing went up 73 percent, in the period of time here, yours has gone down by about 10 percent while the volume of trading and activity, as we mentioned earlier, has increased dramatically.

Let me ask you this. Is the \$17.9 million increase in funding that the President seeks adequate for you to meet your responsibility to protect those who were involved in this marketplace?

Mr. JEFFERY. Thank you, Mr. Chairman, for that excellent question. The \$17 million—let me put that into perspective. Of that \$17 million, \$14 to \$15 million is simply to maintain current levels of operating activity. That pays for built-in cost-of-living increases, salary increases, et cetera, leasehold increases, and other operating expense increases of a normal course nature. Only \$3 million of that number is for an increase in service, if you will. That will allow us to hire an additional 17 full-time equivalent employees. I would say that—were Congress to approve, to appropriate \$116 million for the CFTC this year—in our view, it would help maintain current levels, modestly increase our capability in certain areas but it should be viewed as a beginning not an end point of addressing what has been, as you correctly point out in your observations, a steady erosion in our capabilities over the course of the past several years.

Senator DURBIN. In the 1980s banking crisis, Congress passed FIRREA, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, which replaced the Federal Home Loan Bank Board with the Office of Thrift Supervision and also provided pay

parity, which you referred to in your testimony, among Federal financial regulatory agencies. You noted in your testimony that you were glad that you were given the authority to pay at equal levels to similar operations in the Federal Government but you also noted that you weren't given the money to raise the pay at your agency so that you could reach parity. Is this, do you believe, part of the reason that you've lost so many staff people in the last 1½ years?

Mr. JEFFERY. Thank you, Mr. Chairman. There are a number of reasons for the staff level reduction, most significantly, budgetary. I should also add that at the CFTC, like many areas of the Federal Government, we're managing what one could describe as a difficult sort of demographic development where there are any number of employees who started at the Commission really at the time of inception, going back 25, 30 years who have now reached that period in their careers, in their lives, where they are eligible to retire in the normal course.

With respect to pay parity, I believe we have funded pay parity to a large extent. Based on the best data we have available today, we're probably about 85 percent fully funded. In other words, on the average and on the whole, our people are at the 80 to 85 percent level relative to their peers at other pay parity agencies that are fully funded. This increment to the budget will allow us to continue to close that gap. I should stress again on pay parity, the importance of having that flexibility for our agency in retaining people who might otherwise be attracted to another U.S. Government financial regulatory agency, let alone the private sector.

STUDENT LOAN REPAYMENT PROGRAM

Senator DURBIN. Chairman, a few years ago I tried to reinvigorate or invigorate, I should say, a student loan repayment program, to recruit high quality individuals to Federal service who might otherwise be discouraged by Federal pay and student debt. I'd like to know if your agency is using student loan repayments to help attract skilled employees?

Mr. JEFFERY. Senator, I don't believe so, Mr. Chairman but I would like to come back to you for the record with a proper and correct answer to that question.

[The information follows:]

The Commission has not had the opportunity to develop the Student Loan Repayment Program as a recruitment tool. Funding constraints have required the Commission to make significant reductions in operating accounts and to place a freeze on the hiring new staff since October 2005. The few limited exceptions to the hiring freeze have been to fill behind key critical losses in hard to fill and one of a kind positions. This limited number of hires has been at the upper levels of management, which is generally not the target beneficiary group of the Student Loan Repayment Program. We understand and appreciate the recruitment benefit of the Student Loan Repayment Program and given the financial flexibility to fill our ranks with more junior talent would look to such a benefit as a key recruitment tool.

CRITICAL INFORMATION TECHNOLOGY SYSTEMS

Senator DURBIN. My last question relates to technology, which was, I think, your last graph. I understand that two of the Commission's three critical information technology systems, market surveillance, and trade practice, are becoming antiquated. I've been advised that \$4 million in investments in these systems and other

crucial technology has been deferred, due to your budget challenges. What impact is this situation having on your ability to keep pace with the rapid, explosive technological, and global growth evolution of the markets, which you have the responsibility to supervise? I think we're all aware that this marketplace has not only changed internally, it's changed externally. We're now in global competition and the technology that is available for around the clock trading around the world is a challenge not only to the markets in the United States but to others and to your agency. So have you been able to keep up in terms of technology changes? Do you have the tools to do your job effectively?

Mr. JEFFERY. Mr. Chairman, technology, as you correctly note, is an extremely important tool to all of us who work in the Federal Government, particularly to a financial market regulatory agency. The \$116 million budget request has within it a technology spend level of approximately \$17 million, which is more than double our spend on technology in the current fiscal year. That allows us to continue to operate our existing systems with some degree of efficacy but it does not allow us to modernize those systems in the way that we believe will be essential for us to continue to be able to fulfill our responsibilities in the years to come as these markets continue to evolve.

They are working currently but we are at risk of them, at some point, becoming outdated if we don't continue to invest in technology and particularly in the two critical systems, trade practice and market oversight, which I described in my testimony.

Senator DURBIN. I'll just conclude and turn to my colleague here by saying that I think that the competitive edge for America in futures trading is the efficiency and integrity of our marketplace. Your agency has the responsibility to make certain that we do everything in our power to protect that competitive edge and to protect those who are participating in the marketplace. When I see the staffing levels that you're struggling with, in comparison even to other agencies of our Government with similar responsibilities, and when I see the problems that you face in developing the technology and capability to keep up with market changes, I'm very concerned. I think that if you are going to be the cop on the beat, you need to have the tools to make sure that you can enforce the laws and catch those who are violating them and I'm worried that this budget will not give you that capability. So we'll take a close look.

Senator Bond.

Senator BOND. Thank you very much, Mr. Chairman. It's a pleasure to be with you on this newly formed subcommittee and I look forward to working with you and Senator Brownback and the other members of the subcommittee. I share your interest and the views that you have expressed and the importance of adequate and effective regulation by the CFTC. I know the chairman has a specific interest in things going on in Chicago as I have an interest in things going on in Kansas City. So we will look forward to working through this subcommittee to provide, try to provide you the assistance that you need to do an effective job in regulation.

And speaking of parochial matters, I noticed that Josh Kinney underwent Tommy John surgery, putting the Cardinals bullpen at risk for this season but I will save my comments for Mr. Preston

because I have a particular area of interest there and I will await his appearance to make my statement about that. Thank you.

[The statement follows:]

PREPARED STATEMENT OF SENATOR CHRISTOPHER S. BOND

Mr. Chairman, Senator Brownback: I am pleased to be with you at the first meeting of the newly formed Subcommittee on Financial Services and General Government. It is an honor to be a member of this Subcommittee. I look forward to working with both of you and other Subcommittee members during the coming months.

Welcome Mr. Jeffrey and Mr. Preston; we are pleased to have you with us.

With all due respect to Mr. Jeffrey, in the interest of time, I will focus my comments on the Small Business Administration.

Mr. Preston, congratulations to you and Ms. Carranza on your successes. SBA under your leadership is a revitalized agency. I am hearing very good things about the agency. So please keep up the good work.

That said, there are a couple of areas of the SBA's Performance Budget that I am concerned about.

With respect to procurement, the Performance Budget states that there will be a review of the Small Business Innovative Research (SBIR) and Small Business Technology Transfer (STTR) programs and "based on these reviews, SBA will recommend legislative, and proposed regulatory, changes." The Performance Budget goes on to state "The SBA will continue to improve oversight and evaluation of SBIR and STTR Programs."

As we all know, the SBIR and STTR programs function as more than simply procurement programs. The SBIR program was created by Congress in the early 1980s to provide new contracting opportunities for small companies and to foster innovation and commercialization of innovative products by small companies.

The NIH SBIR program, for example, helps small medical device, biotechnology and diagnostic firms to access critical early stage capital. These funds help companies get a product off the drawing board and, after a great deal of time and significant additional private funding, to the marketplace.

I continue to be concerned that the SBA is stifling innovation in cutting edge companies in biotechnology and other industries that rely heavily on venture capital funding.

The biotech industry is like no other in the world because it takes many years and intense capital expenditures to bring a successful product to market.

According to a study by the Tufts Center for the Study of Drug Development, it takes roughly 10–15 years and \$800 million for a company to bring just one product to market.

For 20 years—until 2004—the Small Business Administration's Small Business Innovation Research program was a catalyst for developing America's most successful companies, helping to fund the critical start-up and development stages of a company.

But then, the SBA decided that small businesses relying heavily on venture capital research funding no longer qualified for the SBIR program.

The arbitrary change in eligibility standards inequitably penalized biotech firms and has delayed—maybe even prevented—lifesaving drugs and life-enhancing medical innovations from reaching patients and consumers.

Last year I offered legislation to correct this situation which restores the original interpretation of eligibility and allows more biotech and medical device companies again to compete for funding under the SBIR program.

My amendment was included in the Small Business Administration's reauthorization bill, which unfortunately fell victim to late session realities at the end of last year.

I am also concerned about the Administration's lack of enthusiasm for the HUBZone program.

Ten years ago, as Chairman of the Small Business Committee, I wrote the legislation authorizing the Historically Underutilized Business Zone, or HUBZone program.

Enacted in 1997, the program provides an incentive for companies to locate and provide jobs in the nation's inner cities and depressed rural areas by giving them a government contracting preference.

Last time I checked, there was still a need for good jobs in the distressed areas of our big cities and small towns.

I look forward to working with you on these and other small business issues.

Thank you, Mr. Chairman.

Senator DURBIN. Thank you, Senator Bond and I also note for the record, this is the 99th anniversary of the last World Series appearance of the Chicago Cubs.

Senator BOND. That's why I'm glad you're also a Cardinal rooster.

Senator DURBIN. He knows my roots.

Senator BOND. I hate to blow your cover.

Senator DURBIN. He knows my roots in east St. Louis, Illinois. I just—I'll close by thanking you for being here. We will work informally with you beyond this hearing to talk about your staffing and technology needs. I really have a special interest in this because I know how important these markets are to the United States and to my home State of Illinois and I know the people there want to make sure that your agency has the tools and the resources to be effective. Chairman Jeffery, thank you for testifying today.

Mr. JEFFERY. Thank you very much, Mr. Chairman. It's a pleasure.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. As I mentioned at the outset, for those who weren't here, we have a 9:30 vote and I'll have to—it was originally scheduled for 9:15. I think it was changed to 9:30. We'll double-check on that and so I may have to break and leave here to tend to my responsibilities on the floor and then return.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR SAM BROWNBACK

Question. Some members of Congress have introduced legislation placing additional regulations on energy derivatives and the over-the-counter (OTC) markets? Do you think these proposals are necessary?

Answer. We believe that the CFTC has adequate authority to address fraud and manipulation on the regulated futures exchanges subject to CFTC oversight. In regard to transactions on Exempt Commercial Markets (ECM) or bilateral over-the-counter (OTC) transactions, the CFTC supports legislation that would clarify the Commission's fraud jurisdiction in certain principal-to-principal energy transactions under the Commodity Exchange Act (CEA). The CFTC requested the enactment of such legislation during the reauthorization proceedings conducted in the 109th Congress. We support this clarification that the CFTC has the authority to bring anti-fraud actions in off-exchange principal-to-principal transactions, such as those connected with Enron Online. These provisions were included in the House-passed reauthorization bill last year and the bill reported out of the Senate Agriculture Committee.

In regard to legislation directed at ECMs, it is important to note that in recent months the CFTC has exercised its existing "special call" authority under the CEA to obtain market information from the electronic ECM operated by Intercontinental Exchange (ICE) in Atlanta. The CFTC has utilized this authority to request trader position data on an ongoing basis related to those ICE natural gas contracts that are directly linked to NYMEX contracts. Compliance with these special calls by ICE is mandatory, not voluntary. These special calls have enhanced the CFTC's surveillance of the NYMEX contracts by providing a better window into this marketplace. In regard to the trading of futures contracts based on NYMEX crude and heating oil contracts traded on ICE's London subsidiary, a foreign board of trade fully regulated under U.K. law, the CFTC also has stepped up its coordinated surveillance efforts with the Financial Services Authority in the United Kingdom and is receiving position information on those contracts on an ongoing basis as well.

In regard to bilateral OTC energy transactions, legislation proposing additional regulation could confront significant practical obstacles due to the absence of a centralized marketplace. Under existing enforcement authority, though, the CFTC's Division of Enforcement has committed significant resources to combating problems in

the energy arena, and has achieved significant success in prosecuting manipulation and false price reporting cases. During the last four fiscal years, the CFTC has filed actions charging more than 50 defendants with false reporting, attempted manipulation, or manipulation in the energy sector and has obtained over \$300 million in penalties. These cases have been based on well-established CFTC cash market enforcement authority that has been clearly recognized by the courts.

Since the passage of the CFMA in 2000, the futures markets continue to rapidly evolve and grow, domestically and globally—and the CFTC is always monitoring these developments.

Question. It is my understanding that some companies use these over-the-counter (OTC) trading markets to hedge their energy risk and that some of the proposals may provide a disincentive for companies to use these markets. Would a decrease in participants in the OTC markets lead to less transparency?

Answer. There are a number of different kinds of over-the-counter markets, all of which have different levels of transparency. They include cash spot and forward physical markets, bilateral OTC swaps and options markets, and ECMs. It is possible that regulations aimed at increasing transparency in some OTC markets generally could discourage some traders from participating in these markets, resulting in their trading positions being moved to venues not visible to U.S. regulators. However, transparency to the regulator will not necessarily be less than is currently the case. For example, as discussed in the answer to question number one above, transactions moved to ICE in London actually became more transparent to foreign regulators and the CFTC. Finally, it is important to note that exchange markets under CFTC jurisdiction are among the most transparent in the world for both market participants and the regulator.

Question. I am concerned with the recent regulatory direction that the Commission has taken, in apparent conflict with the spirit and intent of the Commodity Futures Modernization Act of 2000 (“CFMA”). As you know, the CFMA eliminated prescriptive regulation in favor of Core Principles that provide exchanges flexibility in determining the best method for achieving compliance with each such guiding Principle. An example of my concern with your regulatory direction is the Commission’s final rules regarding acceptable practices for safe harbor compliance with Core Principle 15 pertaining to conflicts of interest in self-regulatory organizations. While there are a few provisions within this final rule that I have concerns with, one in particular is the definition of a “public director” which by its literal reading would appear to exclude almost everyone in corporate America and academia. The test of \$100,000 of payments from the exchange or any member or affiliate thereof collectively will result in not only a requirement difficult if not impossible to test for, but will eliminate nearly everyone an exchange could draw from for public director service. How do you expect exchanges to cope with such a wide reaching “public director” definition that eliminates almost all qualified possible public director candidates?

Answer. The CFTC is strongly committed to both the spirit and intent of the CFMA. The CFTC believes that its new Acceptable Practices for Core Principle 15—safe-harbors which exchanges may choose to implement—are an important indicator of that commitment. The Acceptable Practices promote the flexibility inherent to all Core Principles while simultaneously offering the specificity necessary for effective, “pre-approved” regulatory safe-harbors.

With respect to the definition of “public director,” the CFTC has determined that it is important to offer all exchanges a clear articulation of those director relationships that may interfere with a director’s ability to deliberate objectively and impartially. The definition of “public director” adopted by the CFTC reflects that determination, and is consistent with Core Principle 15’s instruction that exchanges must minimize conflicts of interest in their decision-making processes. The CFTC is confident that qualified, competent public directors are available and can be readily identified by all exchanges.

At the same time, as sometimes is the case with legislative text or rule making, the Commission recently proposed certain technical amendments to the definition of “public director” in the Acceptable Practices to correct a drafting error and clarify ambiguities. Among other things, the proposed amendments would clarify, with respect to the \$100,000 payments from the exchange test, that “payments” means compensation for professional services. The amendments also provide that, consistent with the Acceptable Practices as originally proposed, entity affiliates of members are not included as payment providers for purposes of the \$100,000 payments test. The Commission believes that these amendments should facilitate the inclusion of public directors on exchange boards while maintaining the strong level of public director independence intended by the Acceptable Practices.

The proposed amendments to the definition of public director will be published in the Federal Register and will be open for a 30-day public comment period.

QUESTION SUBMITTED BY SENATOR WAYNE ALLARD

Question. CFTC is currently the only federal financial regulator that is not supported by fees paid by the entities it regulates. Accordingly, the budget proposes a new transaction fee to fund the commission. Can you please describe how this fee would work? How would the fee be paid and at what level would it be set? What would be the impact in the marketplace of adding a new transaction fee?

Answer. In the President's Budget for fiscal year 2008, the Administration included a user fee based on its view that it is appropriate for futures markets to at least partially offset or contribute toward the cost of providing those programs which provide clear benefits to market participants. Unlike last year's proposal, this year's budget recommendation is not dependent on the Appropriators enacting the fee proposal.

If enacted, the proceeds from the fees would be returned to the general fund of the Treasury, to be used to offset the deficit impact of continuing to fund the CFTC's operations through direct appropriations. They would not impact the discretionary spending allocations for the relevant Appropriations subcommittees. The fees would be set at a level equal to the costs to the taxpayer of funding Market Oversight and Clearing & Intermediary Oversight functions, about \$86 million during 2008. The Office of Management and Budget in the Administration has not provided us with final details as to how exactly the fee would work or at what level it would be set.

The CFTC has not studied the impact of a transaction fee, nor is it aware of any executive branch agencies that have done so. The Congressional Research Service prepared a report entitled "The Proposed Transaction Fee on Futures Contracts" in April 2006 (RS2241).

SMALL BUSINESS ADMINISTRATION

STATEMENT OF HON. STEVEN PRESTON, ADMINISTRATOR

Senator DURBIN. But at this time, I'd like to ask the Administrator of the Small Business Administration, Steve Preston, to please come to the table.

I started a few minutes early, Mr. Preston and said a few words about your agency and the budget request so if you'd like, I'd invite you now to give us your opening statement.

Mr. PRESTON. Great, thank you. I'd hoped to start on a high note but after your comment about the Cubs, I'm a little depressed. So I'll try to regroup here.

Thank you, Chairman Durbin and Senator Bond, for inviting me here to talk about our 2008 budget and I'd also like to thank you for the support you all gave us in getting through the 2007 process. We're very excited about the funds that we have for this year and we think we can do a lot with them.

As of tomorrow, I will have been on the job for 8 months. I also want to thank you for approving our Deputy, who was confirmed in December. She is a terrific addition to our team, with 30 years of business experience.

Our 2008 budget request reflects continued commitment to America's small business and the vital role they play in our economy and in our society. Enactment of this request will enable us to continue serving the small business community while also being a good steward of taxpayer dollars.

The SBA's 2008 budget requests \$464 million in new budget authority. This is a 5-percent increase over the enacted level in 2006—that's including disaster and congressional initiatives. The budget also requests the use of \$329 million in carryover balances to fund disaster assistance, funds that SBA has on hand from the \$1.7 billion in supplemental funding from fiscal year 2006. Finally, it includes \$21 million in reimbursable expenses for E-Gov, Business Gateway and SDB certifications as well as lender oversight. All told, that is \$814 million in overall budget authority.

The budget will allow the SBA to carry out its core functions and begin a number of reforms and improvements. These resources will support a total of up to \$28 billion in small business financing through the 7(a), 504, and SBIC Venture programs. For the 7(a) program, we're asking for \$17.5 billion in lending authority. For the 504, \$7.5 billion and then for the SBIC Venture Capital, the Debenture program, \$3 billion.

Because of the strength of our portfolios, I'm pleased to request fee decreases for the 7(a), 504 and SBIC Venture programs. In this budget, the 7(a) annual fee will go down 5.6 basis points, from 55 to 49.4 basis points. The 50 basis point up-front fee for the 504 program is totally eliminated and the SBIC Venture annual fee decreases 18.9 basis points. These fee reductions are significant. They

reflect the success of the zero subsidy program in all of our loans. As you can see from the fee history table that we provided, the 7(a) upfront loan fees for 2005 and 2006 are consistent with those throughout the past decade except for the 2003/2004 timeframe. In a reaction to the economic impact of 9/11, Congress cut the fees for that period of time.

Unfortunately, the result of cutting the fees was to increase the rate at which the SBA subsidy was used, which ultimately shut down the program and required additional appropriation. Zero subsidy has avoided those types of shut downs while the 7(a) program has continued to flourish.

For disaster loans, our proposed 2008 budget supports a loan volume of \$1.064 billion. That funding comes from carry over from our current disaster funds.

For counseling and training to small business through SBA's network of resource partners, in small business development centers, SCORE, and women's business centers, we're asking for a total of \$104 million.

In terms of our workforce, the budget will support an increase to 2,123 FTEs through the salary and expenses budget. That would include 86 new positions to be added in 2007 and 2008. These additional resources are, in part, replacements for attrition at the agency in recent years but they will also support other things like stronger loan processing and lender oversight, greater support of small business in our Government contracting operations, better employee training and career support, as well as a greater focus on automation and outreach.

SBA has a growing responsibility as a financial manager. Our portfolio has increased 56 percent over the past 5 years and we now have almost \$78 billion in financing to oversee. To meet that responsibility, our budget has requested funding for human capital and information technology.

The budget includes \$4.1 million for investment in the loan operations system upgrade, to provide implementation of a system to replace our current loan information system for both regular loan programs and the disaster servicing program. This major agency-wide undertaking began in 2006 and is on track to be completed by 2012.

It also includes expanded SBIC oversight with \$1.5 million to support evaluation contracts, liquidation planning, and an examination contract. This investment will help maximize recoveries and minimize losses.

We also continue to improve our lender oversight process, which enables us to be more effective in managing credit risk.

Federal contracting dollars are projected to increase by 64 percent over 2001 and as I mentioned before, small businesses share is expected to grow. We expect that to be \$84 billion in 2008. Our responsibility is to ensure that small businesses have fair access to procurement opportunities. What I like to tell people is it's not just a matter of fairness, it's also a matter of competitiveness. Small businesses perform well as suppliers of goods and services. Their size makes them flexible, innovative, and often cheaper than large companies. It does, however, take a bit more effort to find the right small business to fit the bill.

So in our 2008 budget, we are requesting about \$500,000 to help improve our service to the 8(a) HUBZones, STB, as well as women's and veteran's communities. We're proposing to add nine new procurement center representatives in 2007 and 2008, which is an expansion of 16 percent. In addition, we're working to reform the contract goaling and reporting processes and we're redoubling our efforts to ensure that Federal agencies provide accurate data on small business procurements.

For 2008, we are also requesting an increase of \$500,000 to expand our veteran's outreach. With the Nation's current engagement in Iraq and our presence in Afghanistan, the number of veterans returning from active duty is going to continue to increase. Our Office of Veteran's Affairs plans to increase its efforts to educate and provide programs and services to veterans and active duty personnel in three major areas: access to capital, management and technical assistance, and procurement assistance.

Even though we've already made many reforms in our disaster assistance program, we're committed to lasting reforms geared toward future disasters, whatever their scale might be. We're developing organizational tools and a detailed documented escalation plan, which we think will improve our response. These plans will include models to rapidly forecast loan volume resource requirements and coordination requirements to position the agency to respond effectively to large-scale disasters.

We are also working to implement an Internet-based electronic application tool to enable borrowers to submit information electronically, quickly and accurately, to accelerate our ability to access their loan eligibility.

The agency is also evaluating options to access the private sector skills and resources when dealing with catastrophic disaster events.

Finally, one of my highest priorities as the Administrator is to improve the work that we are doing to reach underserved areas of our country. In areas where we see high unemployment and lower wage rates, like many rural and inner-city areas of our country providing effective support to new and growing small businesses can provide much-needed jobs, economic activity and rejuvenation in places in our country that need it the most. In order to reach these markets, SBA has included the following proposals in our budget: broadening lender involvement in the Community Express Pilot Program so we can expand this program, which reaches into many of our underserved markets and provides borrowers with a double benefit of capital and counseling; expanding the Urban Entrepreneur Partnership to additional cities so aspiring urban and small business owners have better access to capital and services that will make them successful; establishing seven more alternative work sites, which allows the agency to make itself more accessible to rural customers; and expanding the potential reach of the microloan program by moving the program to zero subsidy.

As I said before, I think this is a sound budget. It gives the SBA the funds necessary to oversee and operate our core financial programs more effectively, to re-engineer and improve our Government contracting programs and to continue our work with counseling and training partners. It will also enable us to provide more

effective outreach, be easier for our customers and partners to work with through better automation, and fill key staff positions in areas that are clearly lacking in necessary manpower.

PREPARED STATEMENT

So thank you for your consideration and I look forward to answering any questions you might have.
[The statement follows:]

PREPARED STATEMENT OF STEVEN PRESTON

Chairman Durbin, Ranking Member Brownback, distinguished members of the Committee, thank you for inviting me here today to discuss the President's fiscal year 2008 budget request for the U.S. Small Business Administration (SBA).

First, I would like to thank you all for assisting us in obtaining the additional funding for disaster and other agency administrative needs for fiscal year 2007. The added general agency administrative funding will allow us to appropriately address our staffing and other administrative priorities for the remainder of fiscal year 2007. The disaster administrative funding should ensure that the Agency will be able to effectively operate the disaster loan program until late July, barring any unforeseen major disasters. We look forward to working with you to obtain the remaining \$26 million needed for fiscal year 2007 disaster administration in the upcoming supplemental appropriations bill. We appreciate your commitment and understanding of the vital role small business plays in the American economy.

President Bush has been an unwavering supporter of America's small businesses, and his leadership has ensured that they have played a vital role in our economic growth. There have been more than 7.4 million new jobs created since August 2003. We know that the majority of those jobs were created by employers in the small business community. In fact, analysis by the Bureau of Labor Statistics shows that small businesses generated 65 percent of the net employment growth between September 1992 and March 2005. This growth has helped reduce the unemployment rate to 4.5 percent, the lowest rate of the past four decades. By reducing the tax rates small business owners pay and increasing expensing tax provisions on investments, small businesses have more capital available to hire new workers and expand their businesses.

The President is also committed to helping small business owners provide health insurance to their employees by supporting association health plans, allowing small businesses to get the same discounts on health insurance as big businesses. Further, the Administration is working tirelessly to ensure that small businesses are able to grow, and expand opportunities for their workers, by providing regulatory relief and opening markets abroad to ensure that America's trading partners play by the rules and make it possible for our small businesses to export their products.

SBA's fiscal year 2008 budget request reflects the President's commitment to America's small businesses and the vital role they play in our economy. Enactment of this request will enable SBA to continue serving the small business community while ensuring stewardship of taxpayer dollars. The fiscal year 2008 budget request provides resources will total an estimated \$814 million. This amount includes \$464 million in new Budget Authority, \$329 million in spending from carry-over balances for the Disaster Loan program, and \$21 million in reimbursable services.

This budget request reflects both the vision of the Agency's new leadership team and the progress the Agency has made over the past five years in delivering its programs more efficiently. Since 2001, SBA has achieved major growth in nearly all of its programs while simultaneously streamlining processes and developing more cost-effective budget strategies. Fees for all of the Agency's non-disaster loan products have been lowered and for the first time ever the borrower fee for 504 loans has been completely eliminated while continuing to operate the program with no loan subsidy from the taxpayer.

The new management team will continue to pursue this expansion in services to the small business community while aggressively pursuing a Reform Agenda to ensure the Agency's programs are customer-focused, outcome-driven and fiscally responsible and sound. In addition, further enabling our employees to fulfill SBA's mission is an essential element in achieving our objectives in this budget.

REFORM AGENDA

I am pleased to be heading the new SBA management team that includes Deputy Administrator Jovita Carranza, who was just confirmed in December. SBA's agenda

is grounded in the belief that the Agency can improve the effectiveness and impact of its programs and activities markedly, by employing important management principles. These principles will seek to ensure that the Agency is driven by clear outcomes, is focused on serving its customers effectively, enables its employees, and operates a compliant and accountable organization.

The Agency also has a renewed focus on ensuring that its products and services are accessible to entrepreneurs in the nation's most underserved markets—those with higher rates of unemployment and poverty and lower rates of economic progress. This budget request highlights SBA's progress to date and describes the Agency's plans for achieving the vision of the new management team in fiscal year 2008.

In 2001, SBA began a drive to deliver more value to the Nation's small businesses while lowering costs to the taxpayer. By restructuring key Agency operations and reengineering its largest loan programs, SBA has achieved record program growth of 56 percent in the loan portfolio, while reducing its total cost by 31 percent since 2001 through increased operational efficiencies and core program improvements. The most important factor in this cost savings has been the 7(a) loan program's operation at zero subsidy. With Congress' support we were able to change the 7(a) program in fiscal year 2005, saving the taxpayers approximately \$100 million in subsidy and allowing the program to operate without interruption. In years past the program had run out of available subsidy funds which shut the program down until a new appropriation could be approved. With the zero subsidy operation in place the program has been able to expand without the threat of a shut down. Zero subsidy is good stewardship of taxpayers' money while creating a more stable loan program for small businesses.

Through its ongoing restructuring and business process reengineering, SBA has improved and will continue to improve the effectiveness of the taxpayers' dollars supporting small business development. Because of these improvements, SBA will be able to serve record numbers of small businesses in fiscal year 2008 with this budget request.

The principles of SBA's Reform Agenda have already resulted in a dramatic improvement in the Agency's Disaster Loan program. The 2005 Gulf Coast hurricanes resulted in SBA's largest disaster response in its 53-year history. More than 420,000 loan applications from Hurricanes Katrina, Rita, and Wilma (three times the level for the second largest disaster, the Northridge earthquake of 1994) left the Agency struggling to meet its loan processing standards and frustrated many.

Almost immediately after being sworn in as SBA Administrator in July, 2006, I spearheaded a fundamental reengineering of the disaster loan processing operation that has dramatically shortened response times, improved quality, and increased borrower support. Backlogs were virtually eliminated and feedback on the new approach has been overwhelmingly positive. We, however, are not finished with the long-term redesign of the disaster process, and are working aggressively to do so in the coming months.

SBA is bringing the same principles used in disaster assistance reform to administering its business guaranty programs as well. Reengineering of the loan servicing process is underway and will result in better customer service and less operational redundancy. Building upon its success in consolidating 7(a) loan liquidation functions from almost 70 district offices to a single location, SBA is also finalizing plans to consolidate 7(a) loan processing, 504 loan liquidation, and Disaster loan liquidation. These changes ensure that loans are managed more consistently and efficiently. In the case of 7(a) loan liquidation, considerable budgetary savings were also realized.

Modernizing agency operations is challenging, but it is essential. The Nation's taxpayers expect SBA to operate using the techniques and practices of sound fiscal and operational management. Through its proactive efforts to improve productivity and performance, while reducing cost, the SBA has demonstrated its commitment to deliver ever better products while improving efficiencies.

With a guaranteed and direct loan portfolio of over \$78 billion, SBA has a critical role as a steward of taxpayer dollars. While the portfolio has grown at a record pace in recent years, during that time, SBA has been implementing a rigorous, state-of-the-art risk management program. By using industry data and technology, the Agency is replacing the old, primarily manual processes for reviewing lender performance with automated, quantitative risk-based methods to identify problems earlier and more effectively. This approach is improving oversight while there continues to be a period of strong growth in the loan portfolio.

HIGHLIGHTS OF THE BUDGET REQUEST

SBA's budget request represents an increase of 5 percent for fiscal year 2008 above our enacted level in fiscal year 2006 (excluding the Disaster program and earmarks). The overall request is for \$814 million in proposed Budget Authority. This includes \$464 million in new Budget Authority and \$329 million funded out of carryover balances from the \$1.7 billion in supplemental funding received in fiscal year 2006 for the Disaster Program. Some critics have misinterpreted this request by dismissing the \$329 million to be carried over from overages in the disaster loan subsidy account. The creation of State grant and loan programs, the influx of insurance payments previously thought to be uncollectible and other factors have shifted the needs of Hurricane victims. The result is that they need less loan authority than estimated in 2006 but the constant changes and delays in rebuilding require more administrative and staffing needs until the borrowers can actually rebuild. Currently, there is sufficient carryover balance in the disaster loan subsidy account to cover the additional Katrina related administrative costs as well as those for a normal disaster year in 2008. Therefore we have asked for transfer authority from the overage in disaster subsidy to cover administrative costs.

These resources will support a total of \$28 billion in lending authority for small business financing, which represents a potential 40 percent increase over business lending for fiscal year 2006, through the 7(a), 504, and SBIC debentures programs. For its flagship 7(a) program, SBA requests authority for \$17.5 billion—a 27 percent increase over the fiscal year 2006 lending level. SBA also requests authority for \$7.5 billion for the 504 program, a 32 percent increase over loans made in fiscal year 2006—a record year for 504 lending. Finally, SBA requests an SBIC Debenture program of \$3 billion.

In addition, this budget will support the following:

- A disaster loan volume of \$1.064 billion (the Agency's ten-year average based upon fiscal year 1996–2005 average activity, excluding the WTC disaster, adjusted for inflation).
- Counseling and training to small business people through SBA's network of resources partners in Small Business Development Centers (SBDC), Service Corps of Retired Executives (SCORE), and Women's Business Centers.
- Assist federal agencies targeting a total of \$84 billion in prime federal contracting dollars to be awarded to small businesses in fiscal year 2008.
- Investing in the Agency's human capital through job skills training, mentoring programs, succession planning, proactive recruitment of highly qualified staff, and implementation of an automated personnel records system.
- Maintaining employee security through continued implementation of Presidential Homeland Security Directive #12 and support of major security improvements in the headquarters building.
- Continuing the process of implementing a loan operations system to replace the current outdated system in order to better track payments as well as increase the Agency's loan portfolio oversight.
- Enhancing SBIC oversight and recoveries.
- Providing a cost effective microloan program.
- Continuing efforts to make it easier and faster for small businesses to comply with government regulations.
- Improving SBA products, services and delivery.

SBA's budget request will support 2,123 FTE through the Salaries and Expenses budget. This staffing level is an increase over both the fiscal year 2006 actual level and the fiscal year 2007 requested level. SBA has been able to reduce its budgetary requirements and staffing levels over recent years, but these increases are necessary to support critical oversight and portfolio management functions. Nevertheless, SBA has managed significant administrative savings while increasing financing, counseling, and government contracting opportunities for small businesses. SBA has been streamlining its operations and eliminating costly and inefficient programs, including the following examples:

- The Agency centralized its financial processing operations. As a result, 7(a) loan liquidations cost approximately \$18 million less in fiscal year 2006 than fiscal year 2003.
- The Agency created an alternative to the LowDoc program for 7(a). A part of our SBAExpress program, Community Express is 20 times less expensive than LowDoc (\$4,771 per loan approved for LowDoc vs. \$227 for SBAExpress). Lenders still have access to the higher 85 percent guarantee for smaller loans formerly available through LowDoc but benefit from the improved process under other 7(a) products, such as Community Express.

- SBA continues to seek opportunities to reduce rented space. The initiatives we have implemented from fiscal year 2004–2006 resulted in \$3.8 million in annual rent savings.

DISASTER

In the summer of 2006, we initiated the Accelerated Disaster Response Initiative to identify and implement process improvements to help the Agency respond more rapidly in assisting small businesses and homeowners seeking financial assistance after a disaster. As a result, the Agency fundamentally reengineered its disaster loan processing operation to shorten response times, improve quality, and provide greater borrower support. Based on customer feedback, the Agency rolled out an “integrated team” model. Each team comprises 15–18 employees with legal, financial, and other required competencies to ensure timely, coordinated loan processing. Customers are assigned to a case manager on the integrated team so they have a single point of contact that is responsible for guiding them through the loan process and ensuring that SBA is responsive to their timing and other requirements.

Under the new model, case managers now proactively contact applicants to determine what impediments exist to closing loans and making disbursements. In addition, in order to complement SBA’s reengineered process, the Agency has implemented numerous metrics to track application status and performance of employees. All applications are categorized by processing status and type of outstanding issue. This provides management with the necessary information to identify problem areas and implement corrective actions. Further, productivity is monitored to identify areas that require management intervention. These strategies are the foundation for improved responsiveness to borrower needs. For example, the time needed for loan modifications that averaged more than 2 months in July, 2006, now averages 8 days, and continues to decline. In addition, the backlog of loans for modification has declined over 90 percent since July.

Additional organizational planning measures to improve SBA’s disaster response include development of models to rapidly forecast loan volume and resource requirements (financial, human capital, and logistics) to better position the Agency to respond to large scale disasters when they strike. Moreover, SBA is nearing completion of a protocol to leverage its field network to improve local coordination and communication with citizens and other local authorities.

By 2008, SBA expects to implement an internet-based electronic loan application process to ensure that borrowers’ required information is provided to assess loan eligibility. This complements SBA’s investment in the disaster computer system that has been tested to support a four-fold increase in concurrent user capacity to 8,000 users. The agency is also evaluating options to access the private sector’s skills and resources when dealing with catastrophic disaster events.

COMPLIANT AND ACCOUNTABLE ORGANIZATION

Listed below are the actions SBA has initiated and planned along with specific funding requests regarding its loan and investment portfolio:

- Investment in technology for the loan operations system upgrade of \$4.1 million in S&E (to be complemented by about \$4.2 million in disaster funding) for project management support, and to acquire and begin implementation of a system to replace our current loan information system for both regular loan programs and disaster loan servicing. Currently, the Agency’s business loan operation runs on a Cobol-based system which limits technological advancement opportunities and security. The older system is also significantly more costly to maintain. SBA is making good progress on this major Agency-wide undertaking, which began in fiscal year 2006, and is on track to be completed by 2012. Requested funds for fiscal year 2008 will enable SBA to finalize the business vision, develop the project management plan, and finalize technical and functional requirements.
- Expanded SBIC Oversight with \$1.5 million in S&E to continue the valuation contract, develop a liquidation plan, and implement an examination contract. This investment will help maximize recoveries on the \$1.5 billion in the Office of Liquidation, and minimize losses on the currently \$10.3 billion in outstanding leverage and commitments in the Office of Operations.
- Loan and Lender Monitoring System and Lender Reviews—SBA’s Office of Lender Oversight (OLO) has a state of the art loan and lender monitoring system that incorporates credit history metrics for portfolio management. The credit information, combined with SBA lenders’ current and historical performance, allows the Agency to assign risk ratings to lenders. Such ratings provide both an assessment and a monitoring tool for the most active SBA lenders, and are

the primary basis by which lower volume lenders are evaluated. High risk lenders are under direct oversight of OLO rather than the program office. In addition, OLO is responsible for conducting on site lender reviews and examinations. Through fiscal year 2006, the Agency has not had resources to conduct as many reviews as we believe are necessary. However, because the Agency recently received authority for reimbursement for the cost of these reviews, SBA plans to conduct additional reviews in fiscal year 2008.

- Portfolio Analysis Committee—Senior Capital Access and CFO Managers meet monthly to review and assess portfolio trends and identify opportunities for program improvements. This committee is an important component of SBA's risk management program. The committee assesses the risk of the 7(a) and 504 loan programs and performance trends. Based on analysis and management direction resulting from these meetings, program changes, operational initiatives, and other actions are generated. For example, in addition to providing support for the elimination of the LowDoc program, the committee's review efforts resulted in the initiative to reduce the backlog in liquidations and charge-offs in our 7(a) portfolio.
- Lender Oversight Committee—Senior managers meet bi-monthly to review lender trends and review corrective actions for poor performing lenders. As mentioned, Lender Oversight has introduced risk ratings to monitor and evaluate SBA lenders. The committee is also provided results and performance metrics on lender oversight activities such as examination reports, and corrective action plans for lenders under OLO's direct oversight. SBA has placed several lenders under corrective action plans and continues close monitoring to improve performance.
- Lender Portal—Lenders now have access to their risk ratings and performance metrics through our lender portal, making it transparent to lenders what they are rated on and how they compare with their peers. It allows lenders to address data quality issues to improve their risk ratings, which the Agency believes will ultimately result in significant improvements in data quality. The information is also available to SBA's district offices to help identify training opportunities for lenders.
- SBIC Liquidations—SBA currently oversees approximately \$1.5 billion in SBIC leverage in its Office of Liquidation and \$10.3 billion in leverage and commitments in its Office of Operations. Collecting on the large amount of leverage outstanding in the Office of Liquidation continues to be of great concern. The staff has developed a comprehensive strategy for liquidating this portfolio of investments. As part of this strategy, several pilot initiatives for liquidating SBIC assets are being pursued to ascertain the most cost efficient means of disposing of this significant portfolio. With \$2.4 billion in estimated losses in the Participating Securities (PS) program, oversight on the \$10.3 billion in outstanding leverage and commitments for those SBICs (of which almost \$7.2 billion pertains to the PS program) remains of high importance.

In addition, SBA is taking the lead, along with the Office of Management and Budget's Office of Federal Procurement Policy, to work with the contracting agencies to ensure accuracy and transparency of the data in the Federal Procurement Data System-Next Generation (FPDS-NG). The agencies are in the process of validating their fiscal year 2005 data to identify the reasons for coding discrepancies and to correct any errors that occurred.

In fiscal year 2007 we expect that all agencies' subcontracting information will be available in the Electronic Subcontracting Reporting System.

CUSTOMER-ORIENTED

The following are highlights of SBA's plans to focus its products and services on underserved markets:

- Expansion of the Community Express pilot.*—This pilot was designed to reach underserved markets and combines both capital and technical assistance to increase the viability of the businesses it serves. The Agency is working to broaden lender participation in the product and will seek involvement from its counseling and training partners: SBDCs, SCORE, and Women's Business Centers.
- Expansion of the Urban Entrepreneur Partnership.*—The Urban Entrepreneurial Partnership (UEP) initiative is a community-based referral program located in an urban setting. The Agency has been working to expand the initiative to additional cities that will create a local network of small business resource providers serving urban and inner-city communities (UEPNetwork), as initially outlined by the President in a presentation to the National Urban League in 2004.

—*Expansion of Alternative Work Sites.*—One way the Agency has made itself more accessible to small business is to locate certain district office staff away from single urban centers to locations closer to our customers. Currently, there are 22 such alternative work sites in operation. Another 2 are planned by the end of fiscal year 2007. SBA is seeking \$100,000 to set up 7 additional sites in fiscal year 2008.

—*Business Process Reengineering for the Office of Government Contracting and Business Development (GCBDD).*—SBA's request includes \$500,000 to examine how to best serve the 8(a), HUBZone, and Small Disadvantaged Business communities as well as women and veterans. We recognize the Agency can improve the management of these programs, particularly the 8(a) program, and will use these resources to determine how to best serve them—whether through staff realignment and training, or technology improvements.

—*New Markets Tax Credit Pilot.*—In October, the Agency launched the New Markets Tax Credit Pilot Loan Program to provide financial assistance to small businesses in economically distressed urban and rural areas, or “New Markets.” The pilot program allows certain Community Development Entities (CDE) to purchase up to 90 percent of the gross loan amount of SBAExpress or Community Express 7(a) loans up to \$150,000 made to NMTC “qualified” businesses in low-income communities. Administered by the Treasury Department's Community Development Financial Institutions Fund, the New Markets Tax Credit program permits investors to receive credits on their federal taxes of up to 39 percent of investments made in investment institutions called Community Development Entities.

The SBA pilot program, which is only available to 7(a) lenders making new loans through advance-purchase commitments with CDEs, waives a regulation that limits an SBA lender's ability to sell any portion of an SBA guaranteed loan to anyone other than another SBA lender. The waiver allows CDEs with New Markets Tax Credit allocations to purchase up to 90 percent of SBA Express or CommunityExpress 7(a) loans up to \$150,000 made to NMTC “qualified” businesses in low-income communities. The New Markets Tax Credit Program is expected to spur approximately \$16 billion in investments into CDE investment institutions.

These new loans are guaranteed by the SBA. By leveraging the SBA's resources with the Treasury's NMTC program, the pilot will provide additional access to loans and technical assistance to both start-up and existing small businesses in New Markets. Under the program, Community Express lenders will assist CDEs to provide small business borrowers with a package of services including mentoring, coaching and counseling.

—*Zero Subsidy Microloan Program.*—Small business loans under \$35,000 provide a critical level of capital to certain sectors in our economy, many of which are in underserved communities. Our regular 7(a) program reaches many members of this community. In fiscal year 2006, 42,730 loans, representing 44 percent of all 7(a) loans, were made at the microloan funding level (\$35,000 or less). However, additional businesses in target markets can be reached through non-bank micro lenders.

The Microloan program as currently structured is costly to the taxpayer. In fiscal year 2006 it cost approximately 85 cents to the government for each dollar loaned to a Microloan intermediary. Therefore, the Agency is proposing a zero subsidy microloan program. By raising the very preferential rate at which intermediaries borrow from 3.77 percent (below the government's cost of funds) in fiscal year 2008 to 5.99 percent (SBA's all-in cost), the Agency can eliminate the subsidy cost of this program and greatly expand funding for microloan intermediaries. Intermediaries will continue to receive a better than market rate of interest on loans and SBA will be able to offer loans to any eligible intermediary.

Furthermore, SBA is proposing that rather than asking for Microloan Technical Assistance funding, SBA should leverage the skills of technical assistance resource partners, including the Small Business Development Centers and Women's Business Centers located throughout the country, to train and counsel micro borrowers. This has the potential of tripling the number of outlets providing training to micro-entrepreneurs for micro enterprise training and will save almost \$13 million in fiscal year 2008.

—*Expanding the Veterans' Outreach Program.*—The SBA requests an additional \$500,000 for the Office of Veterans' Business Development (OVBD) in fiscal year 2008. With the Nation's current engagement in Iraq and its presence in Afghanistan, the number of veterans returning from active duty will continue to increase. SBA's Office of Veterans Business Development (OVBD) plans to in-

crease its efforts to educate and provide programs and services to veterans and active duty personnel in three major areas: access to capital, management and technical assistance, and procurement assistance programs through SBA, other government agencies, and the private sector. The Agency will accomplish this through existing loan programs, the disabled-veteran-owned business government contracting program, a redesigned website populated with a broad range of programs and services available to veterans, the development of training and mentoring programs for veterans by veterans, and funding District Offices to grow veteran-owned business capacity.

Other customer-focused plans include:

- Helping businesses with compliance through the 24/7 anywhere accessible Business Gateway. SBA requests \$4.8 million in reimbursable budget authority for the E-Gov initiative for which SBA is the managing partner and \$425,000 in S&E for the project management office (SBA's contribution as managing partner). Business Gateway will provide the Nation's businesses with a single, internet-based access point to government services. It will simplify and improve businesses' ability to locate and submit government forms and reduce the time and effort needed to comply with government regulations. Each year, Business Gateway will increase the time saved by business accessing information and forms by 50,000 hours over fiscal year 2006.
- Increase access to Federal procurement opportunities by adding 9 new Procurement Center Representatives in 2007 and 2008. With total Federal contract dollars projected to increase by 56 percent over fiscal year 2001, the small business share is expected to increase to a total of \$85 billion. SBA's responsibility is to ensure small business retains access to these opportunities.
SBA will also continue the development of the Electronic Procurement Center Representative System. During fiscal year 2006, SBA began working on an Electronic Procurement Center Representative (EPCR) System to allow PCRs more timely information about contracting opportunities for small business. It also worked with the Department of Defense to integrate EPCR functional requirements with the DOD's capture of additional pre-solicitation information, and explored possible expansion of existing shared systems in the Integrated Acquisition Environment (IAE). The Agency will prepare a business case and will pursue systems design and development in fiscal year 2008. SBA has put into production automated systems for 8(a), Small Disadvantaged Businesses, and HUBZone applications, and will soon finalize the electronic review and certification processes.
- Expanding the reach to the eTran system, which provides a web-based portal for loans guaranteed through the flagship 7(a) loan program. Seventy percent of our 7(a) loans come in through this portal. Expanding the functionality of eTran will further automate lender interactions. In addition, SBA is working with lenders to identify and address other cumbersome processes, which can deter lenders from marketing certain of SBA's products. The Agency is currently developing a web-based system expected to be used by both surety bonding companies and the small businesses seeking bonding.
- Enhancing its Entrepreneurial Development Management Information System (EDMIS), used by its technical assistance partners, to simplify the system's use and capture better information.

EMPLOYEE ENABLED

The following are actions to keep our employees safe and able to fulfill the Agency's mission:

- Professional guard services.*—\$1.1 million in S&E to support professional guard services, operation of a magnetometer for the building, and training for the guards, in order for the Agency to increase security to the level recommended by the Federal Protective Service.
- Implementation of government-wide biometric security cards.*—\$600,000 in S&E (complemented by about \$600,000 in Disaster funding) for the full implementation of Presidential Homeland Security Directive #12, which requires the development and implementation of a government-wide standard for a secure and reliable new identification card issued to Federal employees and contractors. The overall goal of HSPD-12 is to achieve appropriate security assurance by verifying the identity of individuals seeking physical access to Federally controlled government facilities and electronic access to government information systems.
- Centralized training efforts.*—\$550,000 (similar level to fiscal year 2006) for a skills gap assessment for mission critical occupations; an electronic learning

tool; learning management systems; management and leadership development training; a mentoring program; succession planning; and a program to help staff balance the demands of their professional and personal lives.

- Training for Risk-Related Activities.*—\$140,000 to keep procurement and business development staff current on complex changes; \$235,000 for training of Regional and District administrative officers authorized to commit funds on behalf of SBA; and \$90,000 for training of staff involved in acquisition activities, which are inherently high-risk, Agency-wide.
- Proactive recruitment.*—\$123,000 to attract the necessary skilled personnel needed for succession planning. By 2009, 34 percent of SBA's workforce will be eligible to retire.
- District Office program oversight staff.*—\$100,000 to ensure continued monitoring and oversight of SBDC grant and policy issues, adherence to procedures and knowledge of the program announcement.
- Enterprise human resources integration system.*—\$800,000 to integrate SBA's personnel record keeping into this government-wide record keeping system covering the entire life cycle of Federal employees to replace the current Official Personnel Folder.

OUTCOMES DRIVEN

To fulfill its mission, it is critical that the SBA understand how to drive outcomes aligned with that mission. SBA is proud of its work on budget and performance integration which has allowed the Agency to maintain a green rating in both status and progress since fiscal year 2004.

The Agency recognizes it still has work to do, particularly in defining our programs' outcomes. As such, SBA has contracted with the Urban Institute to analyze our business loan programs with results due in fiscal year 2007. In addition, the Agency is analyzing penetration of its lending products into various place-based and people-based groups to understand their impact more fully.

In Spring fiscal year 2007, the Agency will complete a major review of its Strategic Plan. The review will incorporate information from SBA's financial assistance programs' evaluation, as well as the new SBA leadership team's vision. In addition, reporting, measurement, and goal attainment is being designed to align the most critical outcomes the Agency is working to achieve.

CONCLUSION

In closing, this is a good budget for America's small businesses and America's taxpayers. I look forward to working with you to enact this budget and to help entrepreneurs start, build and grow their small businesses. Again, thank you for inviting me here today and I will be glad to answer any questions.

Senator DURBIN. Thank you very much. I stated at the beginning of this hearing that we have a rollcall, which begins at 9:30. I'm going to ask a few minutes of questions and then turn to my colleagues, Senator Bond and Senator Allard and then, after they've asked those, we will recess until after the rollcall votes when I will return with a longer list of questions, probably around 10:15. I apologize for the interruption but this is beyond our control at this point.

SMALL BUSINESS DEVELOPMENT CENTERS

So let me just say first that I'm concerned, Mr. Preston, about the small business development centers and the amount of money that is being requested in this budget, if this turns out to be a pretty good investment for Federal taxpayers. We spend about \$87 million nationwide and according to SBA statistics, we create small businesses that generate five times that amount in Federal tax revenues. So for every dollar that we invest in these centers, businesses are created employing Americans and generating tax revenues at a rate of 5 to 1. That's a pretty good investment.

And yet, there are suggestions here that we are going to cut back on the small business development centers. I'd like for you to ad-

dress this in terms of whether we are, in fact, going to squander an opportunity here to help a lot of people who need help at the expense of business creation. Also, from a minority perspective, we're very concerned about the creation of minority businesses. According to studies commissioned by the SBA, small businesses are the greatest source of net new employment in inner cities comprising more than 99 percent of establishments and 80 percent of the employment in inner cities. However, the 4-year survival rates of minority-owned businesses are lower than the survival rates of non-minority owned businesses. More than one-third of the people who come in to these development centers are minorities. As we cut back, it reduces opportunities for minority expansion for cities and as I mentioned earlier, it reduces the opportunity for businesses to be created, generating tax revenues.

Do you think this is a good choice of expenditures at the Federal level?

Mr. PRESTON. Well, let me just start out by saying two things. Number one, they are a very important part for us. In fact, the small business development centers as well as the women's business centers and our SCORE network are really the cornerstone of our business training and counseling effort at the SBA. And I also acknowledge the criticality of certain minority businesses; in fact, a lot of what we're focusing on strategically right now is how to reach deeper and more effectively into that community because driving small business ownership in the inner city as well as in some of the rural markets where we see difficulty, we think can be an absolute game-changer. So I appreciate the question.

The SBDCs—we are not the primary source of funding for them. We are a core tier of funding that gives them the stability to run a core level of operation, provide overhead, provide hiring to a certain degree but then they also have external fundraising efforts and we encourage them to do that. We are working, in fact, right now with women's business centers on a trial basis to help them become more effective in external fundraising and to bring best practices to bear and we would like to have that type of a dialogue with the SBDCs as well.

So I guess, Senator, I look at it as we are a very significant layer of funding to them. We enable them to go and do things that they might be able to do otherwise but we would like to work with them and encourage them to expand their external funding sources because we do think that expanding their reaches is important.

Senator DURBIN. I know that you've testified to that before but I think that you're overlooking the fact that that Federal investment is an incentive for non-Federal sources and as we back off of it, I hope that you're right but we may be wrong, at the expense of a lot of opportunities. I'm going to leave at this point and turn it over to Senator Bond and you'll have a 5-minute clock and then turn it over to your colleague, Senator Allard and Senator Allard, if you could stay that long, if you'd be kind enough to recess the hearing at the end of your question and we'll resume at about 10:15.

Senator BOND [presiding]. Thank you, Mr. Chairman. Senator Allard can run faster than I can so we will—you're younger and in better shape.

Congratulations, Mr. Preston, to you and Ms. Carranza, on the successes. I'm hearing very good things about the SBA under your leadership and the revitalization.

Mr. PRESTON. Thank you.

SMALL BUSINESS INNOVATIVE RESEARCH

Senator BOND. But there are a couple of areas I want to highlight very quickly with respect to procurement. The performance budget states there will be a review of the small business innovative research, SBIR, and the small business technology transfer, STTR programs. Based on these reviews, SBA will recommend legislation and propose regulatory changes. It goes on to state the SBA will continue to improve oversight and evaluation of SBIR and STTR. As we all know, they function more than simply as procurement. SBIR was created in the 1980s, to provide new contracting opportunities for small companies and to foster innovation and commercialization of innovative products by small companies.

The National Institutes of Health SBIR program, for example, helps small medical device, biotech, and diagnostic firms access critical early-stage capital to get the product off the drawing board and I continue to be concerned that SBA is stifling innovation in biotechnology and other industries relying heavily on venture capital. Biotech industry is heavily dependent upon capital expenditures, 10 to 15 years, \$800 million for a company to bring just one product to market.

For 20 years until 2004, your agency was a catalyst for developing America's most successful companies, helping to fund startup and development. But then SBA decided that small businesses was relying heavily on venture capital no longer qualified for SBIR and that inequitably penalized biotech firms and has delayed, maybe even prevented life-saving drugs and life-enhancing medical innovations and I believe in certain circumstances, has driven them abroad.

Last year, I offered legislation to correct it. It was included in the SBA reauthorization, which fell victim, like everything else, to the delays and filibusters at the end of the session. I might also note, I'm equally concerned about this administration's continuing lack of enthusiasm for the HUBZone program. Ten years ago as chairman of the authorizing committee, I wrote the legislation authorizing the historically under-utilized Business Zones or HUBZones, to provide incentives for companies to locate and provide jobs in the Nation's inner cities and depressed areas by giving them a Government contracting preference. As you yourself have just said, there is still a great need for good jobs in the distressed areas of big cities and small towns and I'll look forward to working on that with you.

But one point I want to make. I have this chart that came from NIH and it shows the base application rates for the SBIR program and the RO1 program. This is significant because it shows when the new regulations were applied to a specific company, Cognetixs, in 2003 but the agencies did not fully implement them until 2004. So it's fair to say that these 2005 and 2006 numbers where the application rates fell off significantly in percentage terms, are a result of the venture capital rules. And the chart also includes the RO1

applications, the largest NIH grant program for universities and academia. So while the SBIR program was falling off, it shows that applications for the RO1 grants continued to increase. I think this makes a very strong case to show that the decrease in SBIR applications is specific to the SBIR program and not a result of scientific trends. Would you agree with that?

Mr. PRESTON. Well, I would certainly want to dig into the data further, Senator, to understand what it implies. One of the things we have, we are waiting right now, is a study from the National Academy of Science that looks at the whole SBIR program and the value of it, et cetera, et cetera. I do agree, it's a critical program for getting capital to companies that are involved in the commercialization stage that are small. Venture capitalists can own up to 49 percent. I think your point is based on the need of the funding. It may need to go over that.

What we're trying to do here is balance the need to get money to small businesses that are viable and have great ideas with ensuring that we get the kind of value out of the program that you're talking about.

Senator BOND. I look forward to discussing that with you further and I'll leave my further questions for the record and turn you over to the tender mercies of the Senator from Colorado.

Mr. PRESTON. Thank you.

Senator ALLARD [presiding]. Thank you, Senator Bond. I appreciate it. I ask unanimous consent that my full statement be a part of the record.

Senator BOND. Without objection.

[The statement follows:]

PREPARED STATEMENT OF SENATOR WAYNE ALLARD

I would like to thank Chairman Durbin for holding the first hearing of the new Subcommittee on Financial Services and General Government. I was fortunate to work with him as my Ranking Member on the Legislative Branch Subcommittee during the previous Congress, and I look forward to continuing to work with him in this new capacity.

I am pleased to be a member of this new subcommittee. These agencies are of a particular interest to me, as I am ranking member of the authorizing subcommittee with similar jurisdiction. I appreciate this opportunity to become more involved in their budgetary matters as well.

Coming from an agricultural state like Colorado, I have a keen interest in the Commodities Futures Trading Commission. I will be eager to hear how the CFTC is changing with the financial markets.

I hope Chairman Jeffery will also be making a few comments on the topic of competitiveness. Following the release of the Paulson report and the Schumer/Bloomberg report, competitiveness of the capital markets has become the primary topic of discussions in the financial markets. While most of the discussion focuses on more traditional securities, I am curious to hear more about how futures, options, and the CFTC fit into the picture.

I also hope that Chairman Jeffery will discuss the proposed new transaction fees. This would be a major shift, and I believe it is important to fully understand all aspects of the proposal.

I also look forward to hearing from Administrator Preston of the Small Business Administration. I started and owned a small business, so I am well aware of the challenges faced by small businesses. Once an entrepreneur is able to overcome the hurdle of raising the necessary start up capital, the new business owner faces daunting rules and regulations. The SBA is an important resource for help with both.

It is important that we continue to promote the start up and growth of small businesses in America, since they are a significant sector of the economy.

Small firms

- Represent 99.7 percent of all employer firms.
- Employ half of all private sector employees.
- Pay more than 45 percent of total U.S. private payroll.
- Have generated 60 to 80 percent of net new jobs annually over the last decade.
- Create more than 50 percent of nonfarm private gross domestic product (GDP).

I would like to thank Chairman Jeffery and Administrator Preston for appearing before the subcommittee today. Your perspective will be very helpful as we move forward with your budgets, and I look forward to your testimony.

LOAN OVERSIGHT

Senator ALLARD. I have two quick questions. You have an inspector general report where it says the agency does not have sufficient controls to detect fraud and prevent unnecessary losses. What is your response to that critical statement?

Mr. PRESTON. I think the agency does have sufficient resources. We've significantly increased our lender oversight. We've expanded that group. We've expanded the statistical tools that we use to analyze our lenders. We actually continue to see improvements in the improper payment numbers and I think we've got a great working relationship with our inspector general on these issues. So I think we continue to improve. In fact, right now—

Senator ALLARD. Are you watching your loans on your businesses and being careful—being sure they don't get in some of these exotic loans that we're seeing in the housing market?

Mr. PRESTON. Senator, our loans are set up in very specific programs. So there are only certain kinds of loans we can make.

Senator ALLARD. They are 50 year, 30 year standard payoff loans.

Mr. PRESTON. They generally are even shorter than that.

Senator ALLARD. Okay.

Mr. PRESTON. But mostly they are bank loans that have to fit into a particular framework.

PART

Senator ALLARD. Okay. Very good. The other thing, too is I take a lot of interest in the PART program. Do you know what I'm talking about? It deals with setting goals and objectives that are measurable and examining outcomes.

Mr. PRESTON. Exactly.

Senator ALLARD. There are a few programs under your purview that I don't think quite made the grade on that PART program, maybe just one or two or three. Do you want to comment on that?

Mr. PRESTON. I probably prefer to work with your staff to find out specifically which programs you're considering but we do have PART goals on all of our programs, you're correct, yes.

Senator ALLARD. I'm one that follows that.

Mr. PRESTON. I think that's very important.

Senator ALLARD. I say that just to alert you that whenever you show up in front of me, I'm liable to ask you about the PART program. If you have some programs in there that are lagging in that regard, you'll get some questions from me on that.

Mr. PRESTON. Great.

Senator ALLARD. So you need to be prepared because I think the Government Performance and Results Act has got the right tone

that we need to bring accountability to our agencies. I'm one that believes in that so you'll hear some questions from me on that.

Mr. PRESTON. That's great. I agree with you fully. Thank you.

Senator ALLARD. Very good. You know, I'm not sure you've got any but it seemed like there might have been one or two there. But if not, don't worry about it. If there is, I'd like to get a response to my staff on where you are on those particular programs.

Mr. PRESTON. Great.

Senator ALLARD. I need to go down to the floor and catch this vote, so I'm going to put the subcommittee in recess.

Mr. PRESTON. Great. Thank you.

MICROLOANS

Senator DURBIN [presiding]. Sorry for the delay and I thank you for your patience, Mr. Preston. We got a few things done on the floor. I'm sorry if some of this area, some of these questions have been covered but I'd like to ask, if I might, why your budget request this year proposes that the microloan program be operated through higher interest rates and with zero subsidy. You also proposed to eliminate all technical assistance funding for microloans. Explain to me if you can, how the SBA came up with the statement that it cost 85 cents to make a \$1 microloan and whether that calculation takes into account the ongoing cost of intermediaries providing technical assistance and support to businesses and their portfolio?

Mr. PRESTON. It does, it takes into account two things. It takes into account the technical assistance piece, which is really the primary on it there. I believe the technical assistance piece is \$13 million of the cost and then a much smaller portion, somewhat over \$1 million, represents the subsidy that we currently pay on the loans that we make to the microlenders. So in other words, that's the degree to which the Government subsidizes those loans because we offer them below the Treasury rate.

Senator DURBIN. What is the total dollar amount the SBA currently has in outstanding loans to microlending intermediaries?

Mr. PRESTON. Outstanding—I don't have that number at the top of my head. I know last year we made about \$18 million in new loans. I can get that for you in a second.

Senator DURBIN. Do you know what the average amount of a microloan is?

Mr. PRESTON. In that program, I believe it's \$13,000. It maxes out at \$35,000.

Senator DURBIN. Could you kind of describe the typical recipients?

Mr. PRESTON. The typical recipients of ours, in many ways, are our target group. They are heavily represented by minorities. They reach into the inner cities as rural markets. And there is a heavy representation of women as well.

Senator DURBIN. Which, if I remember from your other testimony, is a high priority for the SBA.

Mr. PRESTON. Exactly. Yes, it is.

Senator DURBIN. So I asked you earlier about the small business development centers, which we understand are used not exclusively but disproportionately by minorities and now we find the microloan

program, which is being cut back. Do you see, from my side of the table, that it looks like you're stating your goal is to reach out to these people and yet your budget says that you won't?

Mr. PRESTON. Well, I think what we're trying to do is expand the capital that we can get out there and try to do it on a cost-effective basis. We're asking for authorization of up to \$25 million—I think last year, we put about \$18 million out there and what we'd like to do is be able to put more money out there but put it out there on a most effective basis.

Senator DURBIN. I'm interested in that cost effective phrase that you just used. If you don't offer as much in microlending, is it not true that those who are seeking the loans will turn to the commercial side, which may be more expensive?

Mr. PRESTON. I think by increasing our cost to the microlender, there will be some increased cost to the borrower. I also think though, there are a lot of microlenders out there that don't take—avail themselves of our funds and we're hoping that by expanding the capital available to microlenders, we'd actually be able to get more capital in the hands of people.

Senator DURBIN. But isn't technical assistance a critical part of this?

Mr. PRESTON. It's absolutely critical.

Senator DURBIN. To make sure the microloans are based on a good business plan, executed well, monitored carefully?

Mr. PRESTON. Yes, it's a necessary component. It's critical but we, Senator, already provide technical assistance to about 1½ million people a year. We have 13,000 counselors in our network and this is 2,500 loans each year. So we're looking to leverage that network to provide that technical assistance to these people. It is a fraction of 1 percent relative to the volume that we already undertake.

Senator DURBIN. I understand you have many people who are involved in small business development centers, SCORE volunteers and SBA technical assistance providers, who step in to assist businesses that receive loans from microlending institutions. I'm not convinced though, that these other technical assistance providers can really provide the same intensive and personalized assistance that microlenders currently provide their own borrowers. Unlike a lot of the SBA technical assistance providers, microlending intermediaries reach out to their borrowers and proactively check to see if they need assistance and what needs they might have. The SBDCs and SCORE volunteers respond to businesses that contact them seeking help. So it's a much different relationship. It's a proactive relationship with the microlending intermediaries and one that is more passive when it comes to these other sources.

Mr. PRESTON. I think that is a fair representation of the majority of the people they work with. I don't know that I would concur that a lot of these people don't reach out and honestly, I've spent many, many days in the field, talking to small businesses that have worked both with our district offices and with the SBDCs and other volunteers and the tight relationship, the consistent interaction, in many cases, is there.

DISASTER LOANS

Senator DURBIN. Let me move to another topic, disaster loans. What is your estimate for disaster loan activity in the next fiscal year?

Mr. PRESTON. We've got \$1.064 billion in our budget request.

Senator DURBIN. And how did you arrive at that estimate?

Mr. PRESTON. That is derived from a 10-year average. Ten-year average, accepting the outlayer years, which is, I believe, primarily Katrina.

Senator DURBIN. In the recently passed continuing resolution, we provided the SBA an additional \$113 million for disaster loan administrative costs for 2007.

Mr. PRESTON. That's right.

Senator DURBIN. How long do you project the program can operate with that amount of additional funding?

Mr. PRESTON. Based on the estimate for a typical disaster year, which never actually occurs, obviously, that would take us well into July, which would leave us short for the last few months. If we would have a year where there was somewhat lighter disaster activities, it's conceivable we could get through the year and certainly if it's a heavier year, that would be an issue.

Senator DURBIN. So what happens if you run out of money in that area in July?

Mr. PRESTON. If we run out of—if we purely run out of money in July, we don't have money to fund new disaster loans in the program and I just want to mention, the money that we have that came through the continuing resolution is less than what we requested in the process. I believe we requested \$140 million, which we thought would take us through the full year.

Senator DURBIN. To your knowledge, will there be an additional request on the supplemental?

Mr. PRESTON. I know we are working with your people on the supplemental.

Senator DURBIN. Okay. Your budget justification talks about the fundamental re-engineering of the disaster loan program and the creation of a disaster reserve. What do you have in mind?

Mr. PRESTON. Well, we've already made a tremendous amount of progress and I would invite you or anyone on the subcommittee to send staff down to our processing center and we'll take you through in detail what we've done. But we have fundamentally restructured the operational processes around how loans are distributed and closed and we continue to drive kind of a—it's a very deep re-engineering, Senator, so it's—I don't want to get in the weeds too much but effectively to put in place processes to make our people more responsive, to give them better customer service along the way, to get loans and approvals processed much more quickly. And it really gets into digging very, very deep into the operational processes and basically fixing some things that were broken.

AGENCY STAFFING

Senator DURBIN. I wanted to ask for a moment about agency staffing levels. We understand your staffing levels have declined significantly over the past several years, though you've only been

there 8 months so some of this precedes your arrival. Can you provide us with a chart for the record, showing the agency staffing levels by year for the past 5 years?

Mr. PRESTON. We can do that.

[The information follows:]

EMPLOYMENT SUMMARY

[Headcount: Based on the HCM Employment Summary Report]

| | 9/30/02 | 9/30/03 | 9/30/04 | 9/30/05 | 9/30/06 | 12/31/06 | Fiscal year 2008 budget |
|--|---------|---------|---------|---------|---------|----------|-------------------------------|
| Headquarters: | | | | | | | |
| Executive Direction | 239 | 257 | 249 | 248 | 230 | 231 | ..... |
| Management and Administration | 95 | 92 | 92 | 94 | 95 | 94 | ..... |
| Chief Information Officer | 53 | 53 | 53 | 53 | 48 | 52 | ..... |
| Capital Access | 159 | 157 | 137 | 132 | 129 | 133 | ..... |
| Entrepreneurial Development | 46 | 49 | 45 | 43 | 42 | 41 | ..... |
| Government Contracting/Bus Dev | 91 | 89 | 74 | 69 | 73 | 72 | ..... |
| Total headquarters | 683 | 697 | 650 | 639 | 617 | 623 | ..... |
| Field: | | | | | | | |
| Field Support to Headquarters ¹ | 257 | 258 | 253 | 250 | 246 | 340 | ..... |
| Field Servicing Centers | 86 | 83 | 150 | 151 | 158 | 164 | ..... |
| Regional Offices | 23 | 26 | 27 | 32 | 31 | 29 | ..... |
| District Offices ² | 1,674 | 1,581 | 1,294 | 1,053 | 1,002 | 899 | ..... |
| Total field | 2,040 | 1,948 | 1,724 | 1,486 | 1,437 | 1,432 | ..... |
| Total SBA funded employees | 2,723 | 2,645 | 2,374 | 2,125 | 2,054 | 2,055 | 2,123 |
| Inspector General | 108 | 98 | 97 | 94 | 102 | 104 | ..... |
| Disaster Loan Making | 854 | 733 | 1,855 | 2,240 | 4,083 | 3,460 | ..... |
| Disaster Loan Servicing | 205 | 159 | 142 | 115 | 101 | 98 | ..... |
| Total SBA employment | 3,890 | 3,635 | 4,468 | 4,574 | 6,340 | 5,717 | ..... |

¹ Field Support to Headquarters includes Legal staff in District Offices, the Denver Finance Center, and Regional Advocates plus others. A complete listing is available upon request.

² The decrease in headcount reflects a reclassification of 91 legal staff from District Offices to Field Support to Headquarters.

Senator DURBIN. Are you concerned that staffing levels have dropped too far, where you can't meet your statutory obligations?

Mr. PRESTON. I'm not. I want to tell you once again, we're particularly heartened by the work you all have done with us for 2007 and with the budget in 2008 because that will allow us to add about 86 people, which I think will be very important for us. We are at a tight level right now but I'm not concerned about our ability to meet statutory requirements.

Senator DURBIN. The Office of Personnel Management (OPM) Survey of Government Employees indicated that a significant number of SBA employees felt they didn't have sufficient resources to do their jobs. How will your budget request provide adequate resources?

Mr. PRESTON. Unfortunately it showed a lot more than that, many of which—many of the items showed that we have a lot of work to do in our employee base. Our people are not trained well enough right now. They are not all allocated to the right activity and we are going through an extensive review right now. We're about to roll out extensive training programs. We're clarifying roles and responsibilities of people throughout the agency to make them

more effective in meeting the needs of the agency. And all of that is very specifically responsive to the OPM tool as well as some surveying that we've done on the side. I also have personally been to many of our district offices and talked with our people.

Senator DURBIN. I just wanted to say—you mentioned at one point in your budget justification a morale problem among the employees.

Mr. PRESTON. Pardon me?

Senator DURBIN. You mentioned a morale problem among employees.

Mr. PRESTON. Yes. It was in the 2004 survey and it was validated by the 2006 survey that was completed in June. So I'm getting a little ahead of things here but in the coming year, every one of our district offices will be goaled on people initiatives, which will include career planning, training, GAP assessments, reviews—all sorts of things that I think are critical. The last thing you want in a service organization is bad morale. So this is something we have to nail and something frankly, I take very personally.

CONTINGENCY PLANNING

Senator DURBIN. I have a series of questions I'd like to submit to you for the record but I want to close by asking you about some of the concerns expressed by the inspector general's office. Concerns were expressed about whether the SBA has devoted sufficient resources to develop comprehensive contingency planning so that it will be able to respond in a quick and effective manner to large-scale disasters, similar to gulf hurricanes. What resources does the SBA budget request allocate toward large-scale disaster planning?

Mr. PRESTON. Well, we are—that is an ongoing responsibility of the senior leadership team for the disaster business but right now we have a very significant team focused both on re-engineering the process, which I mentioned earlier as well as building a detailed sort of disaster search plan that would effectively be like a playbook that you could—that we would be working with to show exactly how we ramp in a major disaster. So I believe the budget we have in place is sufficient to be able to do that but clearly, if a significant disaster hit, we would need to come back for additional funding to handle the scale of the volume.

Senator DURBIN. I understand that part. Funding may be necessary but I guess the question is whether you have a contingency plan so that if you—in the Hurricane Katrina situation, we had some warning. Not much but some and I think it really put all the Federal agencies on notice if they have to respond to a disaster, to think large. Be prepared. Have you done that?

Mr. PRESTON. Yes, we have and I think a lot of the capacity expansion has already happened. The systems capacity is threefold to fourfold what we used in Katrina. We're building a very significant reserve force, which are people that are pre-trained. We will be rolling out in the next couple of months, a training program that will go across all of our district offices, which currently don't exist—don't work with the disaster business. So a lot of the money we have in training and some other areas will be used to support that.

ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. I thank you very much and thanks for your patience. I'm sorry we had to interrupt the hearing and glad that we got the questions in. We'll be working with you on next year's budget, trying to make sure that we provide you the resources the Small Business Administration needs. Thank you.

[The following questions were not asked at the hearing, but were submitted to the agency for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. Mr. Preston, as you see it today, what are the most significant problems currently facing the SBA?

Answer. Since joining SBA I have spent a significant amount of time listening to employees, partners, and most importantly, customers. I have reviewed many of the Agency's programs in order to identify how to build on SBA's successes and address the areas needing improvement. When I came to the Agency, many of our most critical positions were vacant, and some key management processes were broken. I continue to work to build a team of competent leaders and managers, which will be essential in addressing our challenges and opportunities.

My views are grounded in a belief that we can improve the effectiveness and impact of SBA's programs and activities markedly, and therefore our impact on Small Business, by employing important management principles: Focusing on the needs of the customers; Driving outcomes important to our country; and Operating in a compliant, efficient and transparent manner.

Question. To what extent does your 2008 budget request enable you to address these problems?

Answer. The fiscal year 2008 budget request provides ample funding to reform and refocus the Agency so that SBA is able to fulfill its mission to help America's entrepreneurs start, build and grow their small businesses. This funding will support:

- Continued reengineering of the loan servicing process, resulting in better customer service and less operational redundancy. Further, consolidation of 7(a), 504 and Disaster loan liquidations will ensure that loans are managed more consistently and efficiently;
- Sharpened focus on the country's most underserved communities through expansion of the Community Express pilot, the Urban Entrepreneur Partnership, business process reengineering for the Office of Government Contracting and Business Development (GCBD), expansion of Alternative Work Sites, and expanded veterans' outreach, among other priorities.
- A more accountable, efficient and transparent organization through centralized loan operations, operational assessments, an improved loan liquidations process, enhanced lender oversight, and other important initiatives.

Question. To what degree does SBA depend on contracts with information technology providers to administer its disaster loan program? Are you confident that your agency's oversight of these contractors is sufficient?

Answer. There are two primary IT support contracts supporting the Office of Disaster Assistance for its mission critical IT system, the Disaster Credit Management System. The total contract staff represents approximately 50 percent of the ODA's resources performing IT functions at our DCMS Operations Center. SRA, International provides IT support and resources for maintenance of software, network, applications, database, help desk, and project management. IBM is under contract for critical system hosting services with service level agreements for system and network availability and security.

Contract oversight of the service providers by SBA management is proactive and adequate to achieve the objectives of the mission. Planned improvement to system functionality and reliability are on-going activities. The results are consistently successful implementation of these enhancements within the schedule and budget allocated.

Question. Legislation has been introduced in this Congress to allow banks to make SBA-guaranteed disaster loans. What is your agency's position on this legislation?

Answer. SBA is working with banks and other entities to develop a role in the private disaster lending arena. While the current language being proposed is much improved as it gives SBA more flexibility in crafting a workable proposal, we are continuing our discussions with the banking industry. It is important to understand

that this would require a solid plan that balances the needs of disaster victims, the role of the private sector and the Agency's duty to manage the risk to taxpayer funds.

Question. What is the size of your current outstanding loan portfolios in your various programs?

Answer. The table below reflects outstanding principal balances for all of SBA's large loan programs including pre-credit reform era loans as of September 30, 2006.

OUTSTANDING PRINCIPAL BALANCES AS OF 9/30/2006

| | Amount |
|-------------------------------------|------------------|
| 7(a) Business Loans | \$46,137,567,613 |
| 504 CDC | 16,736,723,758 |
| SBIC Participating Securities | 4,818,789,740 |
| SBIC Debentures | 1,988,225,000 |
| All other programs | 1,484,135,591 |
| Total | 71,165,441,702 |
| Disaster | 6,806,142,230 |
| Microloan Direct | 92,330,700 |
| Total Portfolio | 78,063,914,632 |

Question. What procedures are used to provide oversight of lenders and monitor loan performance for your guaranteed loan portfolio? Do you think these procedures and your capacity are adequate?

Answer. In fiscal year 1999, SBA formally recognized the need for greater oversight and risk management of SBA's lenders and loan portfolios, creating SBA's Office of Lender Oversight (OLO). Since that time, OLO has implemented numerous procedures to provide oversight of 7(a) Lenders and Certified Development Companies and to monitor loan performance of the 7(a) and 504 guaranteed loan programs. In Today, OLO continues to implement and improve SBA's monitoring and oversight processes.

The procedures OLO has put in place have taken several forms. The following is a highlight of key procedures. OLO has established a system of risk management through the development of an off-site monitoring and review system for all 7(a) and 504 loans and SBA Lenders that has been recognized as an "industry best practice." OLO has also strengthened on-site reviews and exams of SBA's larger SBA Lenders. OLO has increased interoffice coordination and communications on oversight of high-risk SBA Lenders, though formation of interoffice lender oversight and portfolio analysis continues. Finally, OLO is in the process of implementing other initiatives that will add to its oversight capabilities a more detailed discussion of SBA's Lender and loan oversight procedures and processes follows.

Loan and Lender Monitoring.—System Off-site monitoring is provided through the OLO's Loan and Lender Monitoring System (L/LMS). OLO's L/LMS system was originally developed and implemented in fiscal year 2003. L/LMS enables OLO to perform off-site monitoring of SBA Lenders by providing periodic credit quality and portfolio performance assessments of individual lender portfolios, as well as the overall 7(a) and 504 loan portfolios. L/LMS also uses current and historical performance data to generate predictive measures of future performance. These performance data and predictive measures form the basis of OLO's Lender Risk Rating System.

Risk Rating System.—The Risk Rating System is an internal tool to assist SBA in assessing the risk of each SBA lender's loan operations and loan portfolio. The Risk Rating System enables SBA to monitor SBA Lenders on a uniform basis and identify those institutions whose loan operations and portfolio require additional monitoring or other action.

Risk-based Reviews and Examinations.—OLO has also implemented several measures to improve the quality of on-site SBA Lender reviews and examinations. On-site reviews have been expanded from purely compliance-based reviews into more comprehensive, risk-based reviews. The new risk-based approach was put into operation in fiscal year 2005–06. It includes a review of the SBA Lender's portfolio, its SBA management and operations, and an assessment of the SBA Lender's credit administration policies, in addition to a compliance review. Reviews are generally performed on larger 7(a) lenders and the largest Certified Development Companies (CDCs). Small Business Lending Companies (SBLCs) may receive a more rigorous safety and soundness examination, similar to those performed by federal financial

institution regulators. These safety and soundness examinations include more detailed analyses of some of the same components of the risk-based review; however, the examinations also focus extensively on the financial condition of the SBLC, as measured by the institution's liquidity, capital and earnings strength.

The reviews and examinations are performed by contractors with significant audit experience. Reviews and examinations follow SBA's On-Site Lender Reviews/Examinations SOP. This SOP, published in fiscal year 2006, details review components, procedures, and issues that may lead to review findings. The SOP is available to all SBA Lenders to enable them to understand the review process and help them comply with the requirements of the loan programs SBA contractors receive periodic training covering SBA's on-site and off-site review and monitoring policies and procedures contained in the SOP.

Lender Portal.—The Lender Portal allows SBA Lenders to view their portfolio data online, and compare their performance to the averages of their peers and the overall portfolio. The Lender Portal allows SBA Lenders access to the same information OLO uses to measure risk, and enables the SBA Lenders to be proactive in addressing performance issues rather than reacting to problems after they are contacted. By becoming more proactive in correcting portfolio performance problems, SBA Lenders can reduce SBA's portfolio and SBA Lender risk. Having the Portal information available also assists SBA Lenders in managing their SBA operations and managing their SBA portfolio risk, and can be an important part of their decision to expand their presence in the SBA market.

Corrective Action Plans.—OLO has implemented a corrective action process whereby SBA Lenders work with SBA to address problems and deficiencies identified by OLO through on-site reviews, off-site monitoring and referrals. SBA Lenders are requested to respond to the issues identified and to provide a corrective action plan that addresses the problems. If the institution fails to correct the problem, SBA may then pursue enforcement actions.

Lender Oversight Committee.—Through delegations of authority published in fiscal year 2005, SBA created a Lender Oversight Committee (LOC). The LOC is composed of senior SBA management, as well as OLO management, and meets on a regular basis. Among other activities, the LOC reviews the performance of individual SBA Lenders, and will determine whether to impose certain enforcement actions, as necessary.

Portfolio Analysis Committee.—OLO has also instituted monthly Portfolio Analysis Committee (PAC) meetings. The PAC is comprised of senior and mid-level managers. The PAC reviews overall 7(a) and 504 portfolio performance, trends, and characteristics. The PAC helps ensure that offices throughout SBA are aware of performance activity and potential trends that could affect either loan program.

Coordination with Office of Chief Financial Officer.—As part of the credit subsidy modeling process, the Office of the Chief Financial Officer (OCFO) monitors on a quarterly basis and annually updates purchase and recovery rates for all loan programs. The impact on subsidy rates from changes in purchase and recovery rates are recorded in an analysis of change document that is maintained for all of SBA's loan programs. The CFO attends the monthly PAC meetings. The CFO also provides an analysis of the impact of proposed program changes on the subsidy rates and assists in identifying ways to reduce losses and increase recoveries.

In conclusion, OLO believes that all of the processes and procedures described in this response indicate that SBA has in place a comprehensive system of lender oversight and portfolio monitoring that will reduce the Agency's risk in the 7(a) and 504 loan programs. While capacity in a program of oversight involving over 5,000 SBA Lenders and a portfolio of over \$60 billion is always a challenge, SBA is assisted with contract support. SBA has the statutory authority to charge 7(a) lenders fees to cover the cost of oversight including contractor support. This current fee authority along with the CDC fee authority, if enacted should fully support SBA's ability to conduct oversight. SBA has requested similar fee authority for the DCS in the 504 program to ensure that there are adequate resources available to oversee this program as well.

Question. The 7(a) program makes loans available to borrowers who cannot obtain credit at reasonable terms from the private sector without the federal guarantee. Specifically, what borrowers are you trying to reach? How is this purpose affected by the presence of a zero subsidy for the 7(a) program? Would returning to a positive subsidy help you meet your policy objectives?

Answer. The 7(a) loan program is designed for those borrowers who are credit-worthy (the lender's analysis concludes that the loan will repay in a timely manner and not default based on historical performance and credit histories) but that either do not meet the lender's collateral requirements, require a longer repayment term

than the lender gives to non-guaranteed borrowers for the same use of proceeds, or are for new businesses with an unproven track record.

When SBA under the Bush administration converted the 7(a) loan program to a zero subsidy loan program for fiscal year 2005, the fees supporting the 7(a) program were returned to their pre-September 11 levels. (After September 11, 2001, fees for the 7(a) program were reduced for fiscal years 2003 and 2004 in the hopes of stimulating the economy that suffered from the terrorist attack.) Prior to that, the fees had been the same since December, 2000. Before December, 2000, the fees under the Clinton administration were higher. Since the 7(a) program became a zero subsidy program, the only fee that has been adjusted slightly upward has been the ongoing annual fee paid by the lender. That fee increased by only 4.5 basis points from 0.50 percent to 0.545 percent during fiscal year 2006. For fiscal year 2007, the fee is 0.55 percent, an increase of only one-half of 1 basis point. And for fiscal year 2008, the fee will decrease to 0.494 percent which will bring the fees for 7(a) below those charged pre-11 when the 7(a) program was subsidized.

SBA believes that for the 7(a) loan program, zero subsidy is still the best policy for the long term stability and growth of the 7(a) loan program. Since the 7(a) program went to zero subsidy, SBA has had two record-breaking years of lending.

Volume during fiscal year 2005 (the first year that the 7(a) program was a zero subsidy program) was 95,900 loans—an increase of more than 18 percent over 2004 when the program was subsidized. Volume during fiscal year 2006 maintained this trend and actually increased by another 1,390 loans. Fiscal year 2007 YTD continues to maintain the strong demand by growing another 9 percent as of March 16, 2007.

Question. What is your default rate in the basic 7(a) program?

Answer. The default rate, as a percent of disbursements, for the 2008 budget submission is 6.96 percent.

Question. What is the default rate in the disaster loan program?

Answer. The default rate, as a percent of disbursements, for the 2008 budget submission is 24.10 percent.

Question. On page 10 of the budget justification, you make this statement: “the agency’s entire business loan operation runs on a Cobol-based system developed in-house. Parts of this system are over 50 years old. The system is operated on an expensive mainframe that is dependent on obsolete technology . . .”. What are you doing to address this situation?

Answer. We have initiated the Loan Modernization Program to address this situation. We have formed a Steering Council and assigned a Program Manager. We have also submitted the business case (Exhibit 300) for fiscal year 2008 to OMB. The fiscal year 2008 Budget request includes \$8 million to start acquiring the solution. Currently, we are in the process of developing the acquisition strategy to identify and implement the solution that will replace the Cobol-based legacy systems.

Question. What other significant information technology (IT) systems are currently under development in the agency and what stage are they in?

Answer.

Loan Management and Accounting System (LMAS).—As described in response to the previous question, the LMAS will support FSIO (JFMIP) compliant loan Origination, Servicing, and Liquidation. The project scope includes an Integrated Financial Management System to support FSIO compliant Loan Accounting. LMAS is a financial management, mixed lifecycle system with the bulk of its development costs scheduled to occur in fiscal year 2008.

Business Development Management Information System “e-application”.—The BDMIS e-application will allow the Office of Business Development’s 8(a) and Small Disadvantaged Businesses to submit applications for certification electronically via the WEB. This is an enhancement to an existing Business Development system. BD-MIS is mixed lifecycle system and features the e-application within its development segment.

Disaster Credit Management System, E-Loan Application (ELA).—During fiscal year 2007–08, SBA’s Office of Disaster Assistance (ODA) is developing an Electronic Loan Application that will integrate with DCMS. One of the ODA’s Strategic Management Goals is to offer disaster victims accessible, easy-to-use and time saving services through the electronic filing of disaster loan applications. By using the Internet, ODA plans to transform loan-making into a virtual loan process that provides efficient and timely loan decisions to disaster victims. DCMS is a mixed lifecycle system; ELA represents an enhanced set of capabilities within the development segment of DCMS.

E-Gov Business Gateway.—This is one of 25 E-Gov projects within the President’s Management Agenda for E-government. The Business Gateway provides a government-wide one stop website for use by businesses and entrepreneurs. SBA and part-

ner agencies develop tools to assist small businesses seeking to comply with laws and regulations, locate government forms and obtain relevant government information. Business Gateway is currently a mixed lifecycle system planned to be out of the development stage in fiscal year 2008.

Contract Management System (CMS).—CMS will be an information system enabling SBA to perform end-to-end electronic processing of its internal contracts, bringing the Agency into conformance with OMB's E-Procurement guidance. CMS is a mixed lifecycle system planned to be out of the development stage in fiscal year 2008.

Question. The Office of Inspector General's management challenge #1 also identifies flaws in the procurement system that allow large firms to obtain small business awards and agencies to count contracts performed by large firms towards their small business goals. What resources is the agency committing to allow SBA to fulfill a bigger role in ensuring the accuracy of reporting on small business contracting and limiting errors by contracting personnel and fraud by contractors?

Answer. The integrity of the data reported to Congress and the Public is crucial to provide for the confidence in the Federal contracting system. SBA recognizes this, and is taking the lead, along with the Office of Management and Budget's Federal Procurement Policy to work with agencies to ensure their past numbers are scrubbed and future numbers are accurate. The agencies are currently in the process of validating their fiscal year 2005 data to identify the reasons for coding discrepancies and to correct any errors that occurred.

Question. The Office of Inspector General has issued a management challenge finding serious problems with the SBA 8(a) minority contracting program. What resources is the Agency committing to improve this program and address these problems?

Answer. Because the 8(a) Program is a business development program—not a contracting program—it is intended to foster the 8(a) firm's growth (through various forms of technical, management, procurement and financial assistance) and viability during the nine year term. The 8(a) BD Program is for socially and economically disadvantaged entrepreneurs (which include non-minorities) who meet the eligibility criteria.

SBA is committed to improving the 8(a) BD Program and has committed several resources that are aimed at refocusing the Program to emphasize "business development." On September 30, 2006, SBA engaged a contract to conduct a review/assessment of the business processing functions of the 8(a) BD Program (i.e. those processes related to initial certification, continuing eligibility, management and technical assistance, legislative and regulatory requirements) and design a plan consisting of both short and long term methodologies for re-engineering and improving those functions.

Specifically, this process improvement plan will:

- Identify and define each program element and the requirement(s) related to the delivery of the 8(a) BD Program;
- Identify significant issues and problems that exist;
- Identify key issues in the 8(a) BD Program and processes and systems that need to be updated; and
- Review/assess programmatic requirements to ensure relevance and consistency with legislative and regulatory compliance.

In addition, the Office of Business Development conducts monthly training sessions (via teleconferencing) for BD field staff in SBA's district offices. This training (which covers various programmatic and regulatory issues) is designed to improve 8(a) Program delivery and ensure consistency and uniformity as it relates to servicing 8(a) firms.

Finally, SBA is considering various other changes to the program to promote its integrity and efficiency, and the Agency intends to issue a proposed rule to amend its regulations in the near future.

Question. In particular, one of the actions that the OIG has called upon SBA to take is to exert greater oversight over 8(a) contracts issued by procuring agencies since SBA has now delegated authority to those agencies to monitor compliance by 8(a) contractors with SBA regulations and requirements. What resources is SBA devoting towards conducting adequate oversight to ensure that procuring agencies are fulfilling their responsibilities?

Answer. In an effort to ensure greater oversight as it relates to 8(a) contracts issued by procuring agencies, SBA's Office of Business Development has revised the language in the Partnership Agreements (between SBA and the procuring agencies) to clarify roles and responsibilities. The revised Partnership Agreements specifically require the procuring agencies to monitor 8(a) firms' compliance with contract performance. In February 2007, the Office of Business Development began conducting

training for the procuring agencies with regard to rules and regulations governing the 8(a) Program and the revised language in the Partnership Agreements. This training is intended to ensure that contracting officers and technical representatives are adequately advised of their responsibilities concerning 8(a) contract compliance.

Question. The Office of Inspector General issued an Audit Report in May, 2005 on contract bundling. Excessive contract bundling by agencies limit the opportunities for small businesses to obtain government contracts. That report found that SBA had not reviewed 87 percent of the reported contract bundling by procuring agencies even though SBA has a statutory duty to do so, and had not developed a data base to track bundling activity. The report also determined that there was a lack of resources in that the Agency had only 43 Procurement Center Representatives in the entire country to monitor over 2,000 procurement locations for the Federal Government, and that a large percentage of government contracts were not being reviewed by PCRs. What resources is SBA devoting towards addressing these issues?

Answer. The integrity of the data reported to Congress and the Public is crucial to provide for the confidence in the Federal contracting system. SBA recognizes this, and is taking the lead, along with the Office of Management and Budget's Office of Federal Procurement Policy to work with agencies to ensure their past numbers are scrubbed and future numbers are accurate. The agencies are currently in the process of validating their fiscal year 2005 data to identify the reasons for coding discrepancies and to correct any errors that occurred.

QUESTIONS SUBMITTED BY SENATOR SAM BROWNBACK

Question. Currently the microloan program costs \$0.85 for every dollar loaned. Why is it so costly to administer such loans? How will the program change if it were shifted to zero subsidy as proposed in the President's fiscal year 2008 budget?

Answer. The technical assistance component is a significant factor in the cost of the Microloan program. Subsidized interest rates are another extremely high cost. In addition to Subsidy costs, overhead costs are high since SBA makes direct loans to each microloan intermediary and must continue to process and administer the loan, including additional loan disbursements. The Administration's proposed change in the Microloan program increases the interest rate charged on the loan from 3.77 percent to the microlender to 1.06 percent above the 5-year Treasury rate (estimated in OMB's economic assumption at 4.93 percent). SBA would also eliminate the technical assistance funding for SBA microborrowers, but would provide technical assistance through the Agency's Entrepreneurial Development (ED) resources (SBDCs, SCORE, and WBCs).

The Administration's proposed change in the Microloan program increases the interest rate charged on the loan from SBA to the microlender from 1.25 to 2 percent less than the 5-year Treasury rate (depending on the microlender's average microloan size) to 1.06 percent above the 5-year Treasury rate (estimated in OMB's economic assumption at 4.93 percent).

Question. The fiscal year 2008 budget proposes \$484 million in new budget authority. How would this benefit SBA programs? And specifically, what benefits would be passed along to the American Small Business owner?

Answer. SBA's fiscal year 2008 budget request reflects the President's commitment to America's small businesses and the vital role they play in our economy. Enactment of this request will enable SBA to continue serving the small business community while ensuring stewardship of taxpayer dollars.

These resources will support a total of \$28 billion in lending authority for small business financing, which represents a potential 40 percent increase over business lending for fiscal year 2006, through the 7(a), 504, and SBIC debentures programs. For its flagship 7(a) program, SBA requests authority for \$17.5 billion—a 27 percent increase over the fiscal year 2006 lending level. SBA also requests authority for \$7.5 billion for the 504 program, a 32 percent increase over loans made in fiscal year 2006—a record year for 504 lending. Finally, SBA requests an SBIC Debenture program of \$3 billion.

In addition, this budget will support the following:

- A disaster loan volume of \$1.064 billion (the Agency's ten-year average based upon fiscal year 1996–2005 average activity, excluding the WTC disaster, adjusted for inflation).
- Counseling and training to small business people through SBA's network of resources partners in Small Business Development Centers (SBDC), Service Corps of Retired Executives (SCORE), and Women's Business Centers.

- Assist federal agencies targeting a total of \$84 billion in prime federal contracting dollars to be awarded to small businesses in fiscal year 2008.
- Investing in the Agency's human capital through job skills training, mentoring programs, succession planning, proactive recruitment of highly qualified staff, and implementation of an automated personnel records system.
- Maintaining employee security through continued implementation of Presidential Homeland Security Directive #12 and support of major security improvements in the headquarters building.
- Continuing the process of implementing a loan operations system to replace the current outdated system in order to better track payments as well as increase the Agency's loan portfolio oversight.
- Enhancing SBIC oversight and recoveries.
- Providing a cost effective microloan program.
- Continuing efforts to make it easier and faster for small businesses to comply with government regulations.
- Improving SBA products, services and delivery.

Question. What is the \$100 million savings to taxpayers stemming from the 7(a) loan program being changed to zero subsidy derived from? Are there other benefits to the zero subsidy program?

Answer. The \$100 million savings is an estimate based on the last year (2004) the 7(a) program had a subsidy rate. If the 7(a) program had a zero subsidy rate that year it would have saved the taxpayers about \$100 million.

SBA believes that for the 7(a) loan program, zero subsidy is the best policy for the long term stability and growth of the 7(a) loan program. Since the 7(a) program went to zero subsidy, SBA has had two record-breaking years of lending—years not hampered by slowdowns as a result of moving beyond the projected levels prescribed by Congress legislatively.

Question. What is the potential cost to the taxpayers of reducing or eliminating fees on 7(a)?

Answer. Assuming a loan level of \$17.5 billion the cost to the taxpayers would be \$590 million if all 7(a) fees were eliminated. At the same loan level, the cost to the taxpayers would be \$236 million only if the ongoing fee were eliminated and \$354 million if only upfront fees were eliminated.

7(A) BUSINESS LOANS FOR 2008

| Various Program Levels | Subsidy appropriation needed if: | | |
|------------------------|----------------------------------|-----------------|---------------|
| | No Annual/Ongoing Fees | No Upfront Fees | No Fees |
| \$17,500,000,000 | \$236,250,000 | \$353,500,000 | \$589,750,000 |
| \$16,500,000,000 | \$222,750,000 | \$333,300,000 | \$556,050,000 |
| \$16,000,000,000 | \$216,000,000 | \$323,200,000 | \$539,200,000 |
| \$15,500,000,000 | \$209,250,000 | \$313,100,000 | \$522,350,000 |
| \$15,000,000,000 | \$202,500,000 | \$303,000,000 | \$505,500,000 |

Question. Does the success of the 7(a) change to zero subsidy have any bearing on the fiscal year 2008 proposal for the microloan program to go to zero subsidy?

Answer. The success of the 7(a) loan program at zero subsidy has influenced this decision, especially since the 7(a) Community Express program has surpassed the Microloan program in loans of \$35,000 or less (the definition of a microloan).

Not only does zero subsidy save taxpayers approximately \$.85 for every dollar lent under the current microloan program but it expands the opportunities to reach more microborrowers and provide them with more options for counseling and training.

Question. Can you describe in more detail how the new microloan program would work and its benefits (cost and non-cost related)?

Answer. SBA would amortize each microlender's loan at a rate of 1.06 percent above the 5-year Treasury rate (estimated in OMB's economic assumption at 4.93 percent). SBA would also rely on the Agency's ED resource partners (SCORE, Women's Business Centers, Small Business Development Centers) to provide counseling and assistance instead of providing additional grant money to Microlender Intermediaries for technical assistance which represents a savings of \$13 million over fiscal year 2006 while actually encouraging a wider variety of entrepreneurial development opportunities. Moving to a zero subsidy in the program would also enable SBA to reach out to a larger number of microborrowers across the country. Microlending intermediaries can still access the numerous other Federal, State and Local grant programs for technical assistance and more intermediaries will be able to leverage the more rare lending program offered by SBA. Currently only 172 of the total 600

microlending intermediaries are registered with the SBA microloan program. This proposal would allow SBA to offer lending opportunities to other qualified intermediaries and reach a wider geographic area and market.

Question. How many microlenders are in close proximity, or co-located, with other small business counseling centers receiving federal funding?

Answer. SBA doesn't have information on the locations of all small business centers receiving federal funding, but based on an analysis of the locations of the centers that SBA funds, almost all (about 95 percent) of the Agency's microloan intermediaries are located within close proximity to an SBA ED resource partner, which include SBDCs, WBCs, and SCORE. In addition, SBA believes the approximately 10 intermediaries not located in close proximity to an SBA small business counseling center could be served by circuit rides established by SBA's existing resource partners.

Question. Do microlenders receive funds from other sources? If so, what are they and how much of their funding comes from government sources?

Answer. SBA has not evaluated the alternative funding sources available to SBA's microloan intermediaries or to the microloan industry as a whole. However, according to 2005 information developed by the Association for Enterprise Opportunity, the leading trade association for the industry, in association with the Aspen Institute, there are about 18 federal sources of funding for the microloan industry and undoubtedly a number of state sources.

Question. How would Senators Kerry, Snowe, Landrieu and Vitter's proposal for a private guaranteed lending programs for the regular 7(b) loan program in S. 163 affect the disaster subsidy rate and funding needs?

Answer. CBO estimated that an identical proposal in S. 3778, that the estimated subsidy rates for the different types of business loans and loan guarantees offered by SBA currently range from zero for 7(a) and section 504 programs to about 17 percent for the NMVC program. Incorporating program amendments in this bill and using historical demand and default rates for those loan programs, CBO estimates that the subsidy costs for the authorized levels of guaranteed and direct business loans would be \$23 million in 2007 and about \$128 million over the 2007–2011 period.

Question. How much would the Energy Emergency Loan Program in S. 163 cost?

Answer. *Section 402, Small Business Energy Emergency Disaster Loan Program.*—Based on the information provided, and the proposed loans are funded within SBA's existing Disaster Assistance direct loan program, it appears this proposal will not impact the subsidy rate.

Section 403, Agricultural Producer Emergency Loans.—It appears USDA would provide funding for the proposal but the legislation does not provide sufficient information to estimate the impact on SBA's Disaster Assistance program subsidy rate.

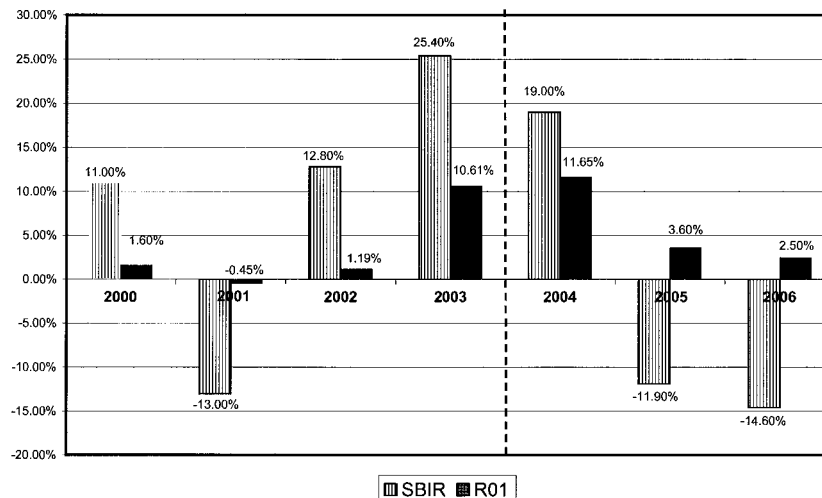
Question. How much would the Energy Emergency Loan Program in S. 163 cost? CBO says it would cost approx. \$85 million (subsidy and admin) 2007–2011.

Answer. We estimate that the administrative cost would be approximately \$50 million.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER S. BOND

Question. With respect to the SBIR program: As I mentioned earlier, I am concerned that we are shooting ourselves in the foot by limiting biotechnology companies' access to this program. We recently received this data chart from NIH. It shows that for the last 2 consecutive years, the number of applications to NIH's SBIR program has decreased. This is significant because the new SBIR rules were first applied to a specific company (Cognetix decision) in 2003, but the agencies (such as NIH) did not fully implement them until 2004. So it is fair to say that the 2005 and 2006 numbers represent the first 2 years that the new restriction on venture capital financing has been fully in effect. Look at the impact on applications at NIH.

Base Application Rates SBIR/R01



The chart also includes figures for R01 applications. I am told that it is the largest NIH grant program to universities and academia. So while applications for NIH's SBIR program fell significantly in 2005 and 2006, applications for R01s continued to increase (albeit at a slower rate than previously). Would you agree this makes the case that the decrease in SBIR applications is specific to something going on with the NIH SBIR program and not a result of scientific trends or some other outside factor?

Answer. The Small Business Administration is currently reviewing the issue of venture capital investment in firms that compete for SBIR awards. The National Academy of Sciences is conducting a study on the SBIR program and expects to issue its report in the coming months. This is an important issue concerning the SBIR program. As such, the Agency will review as it addresses this issue.

Question. Mr. Preston, as you evaluate the SBIR program with an eye toward regulatory or legislative changes, I urge you to look at ways to ensure that the most innovative small firms—including those that raise private funds, such as venture capital—are able to participate in the program. The SBIR authorizing statute listed the raising of private funds by a company as a positive factor that agencies should take into account when awarding SBIR Phase II grants. Congress viewed raising private research funding as a good thing in 1982; that has not changed.

As America's high-technology companies compete for funding in an increasingly global marketplace, the ability to attract and retain capital has become more important than ever. The SBA should not discriminate against good science by small entrepreneurial companies simply because they have been successful in raising venture capital.

Are you willing to work with us to address this problem administratively, so that a legislative fix will not be necessary?

Answer. We would be happy to discuss this issue with you prior to making a final determination.

Question. With respect to the HUBZone program: Our agencies have never achieved the 3 percent minimum mandatory HUBZone contracting level, yet the fiscal year 2008 funding for the HUBZone Program has been reduced to \$8.79 million from an fiscal year 2007 level of \$9.077 million. Why are the funds for this vital program that focuses on the underserved areas of our Nation continually reduced?

Answer. The bulk of the HUBZone Program's funding request is spent on support provided by the SBA district office staff. The services these district office personnel, known as liaisons, provide is twofold. They conduct marketing outreach to the local community and execute the in-depth program examinations that ensure only qualified firms receive HUBZone benefits. Program examinations are executed on approximately five percent of the portfolio and supplement the program's alternate continuing eligibility tool—HUBZone recertification.

A smaller portion of the request (\$2 million) supports the Headquarters staff who are responsible for policy development, certification and eligibility, adjudication of protests as well as maintenance and technological advancement of the HUBZone system. What these funds produced most recently are two online systems dedicated to increasing HUBZone contracts. One system scrubs each day the contracts listed in FedBizOpps and, if it identifies a suitable non-HUBZone contract, a letter is sent to the responsible contracting officer asking that the contract be reclassified as a HUBZone set-aside. The second system, when fully deployed will allow HUBZone certified concerns to generate requests to contracting officials that contracts contemplated in the near-future be reserved for HUBZone firms. It is anticipated that these two internet based tools will increase contracting opportunities for HUBZone firms and assist agencies in achieving the 3 percent statutory goal.

The HUBZone Office is continuing to enhance its multiple systems through the use of high-end technology. The cost savings brought about by the efficient application of technology is reflected in the Administration's ability to decrease the fiscal year 2008 budget request.

Question. The SBA 2008 budget eliminates the separate line item for HUBZone funding. Why is this no longer a priority program for the Administration?

Answer. As seen in Table 6 of SBA's fiscal year 2008 budget request, Note 2 states that funding for the HUBZone program is included in the GCBD Operating Budget. This is the same method of budgeting used for the 8(a) program. For HUBZones, SBA is seeking \$888,000 plus a staff cost of \$1.1 million each year. Our overall financial spending on the HUBZones program is approximately \$9 million. SBA has proposed eliminating a line item that does not accurately reflect our commitment to the program and inhibits the agency from exercising flexibility in its budget. The SBA considers HUBZones a vital part of overall procurement effort.

QUESTION SUBMITTED BY SENATOR RICHARD C. SHELBY

Question. I know there were problems with the Small Business Administration conducting its normal loan business, while addressing loan needs stemming from the impact of Hurricane Katrina. Has this issue been resolved?

Answer. The 2005 hurricanes which hit the Gulf Coast were the largest natural disaster in the history of the SBA. This required an unprecedented response from the Office of Disaster Assistance as well as the dedicated staff throughout the Agency. In response to the Gulf Coast hurricanes, SBA processed over 420,000 loan applications for homes and businesses.

During the same time period, the SBA guaranteed a record number of loans under its two primary small business loan programs, setting records for both the number of loans and the dollars loaned.

So while the Agency certainly experienced some strains and was stretched thin to respond to the overwhelming disaster caused by Hurricanes Katrina, Rita and Wilma, it is safe to say the team at SBA worked hard to overcome these and focus their efforts on serving our small business customers.

SUBCOMMITTEE RECESS

Mr. PRESTON. Thank you very much.

Senator DURBIN. Thanks to all your people who are with you here today. This meeting of the subcommittee stands recessed.

[Whereupon, at 10:35 a.m., Friday, March 9, the subcommittee was recessed, to reconvene subject to the call of the Chair.]